Mergers, Acquisitions and Corporate Restructuring
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Lecture – 02
Introduction to Mergers and Acquisitions – II

Hi friends this is the second lecture in our learning process and mergers, acquisitions corporate restructuring. In the first previous lecture we discussed about the definition of merger, acquisition general definition, we also discussed about difference between merger acquisition, we also talked about how merger, acquisitions have been happening in Indian context (()) (00:47) growth in trend M and A that has taken place.

In this particular session we will be discussing about another way of classification of merger, acquisitions, we also talk about why my M and A takes place, what could be the motives of the companies behind going for mergers and acquisitions as such. We will try to sight an examples also as much possible.

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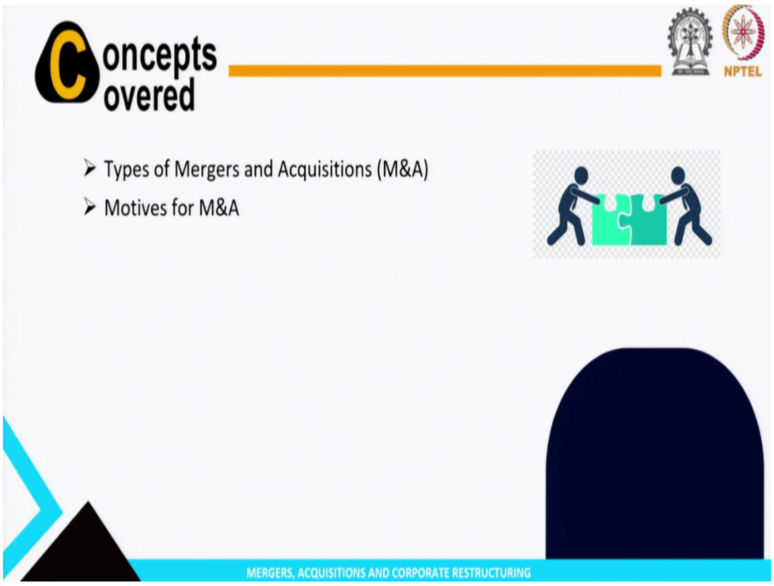

So, in this session we are going to cover different types of mergers and another angle. We will also talk about the motives. These are the two major agenda points or consider we will discuss in this particular session.

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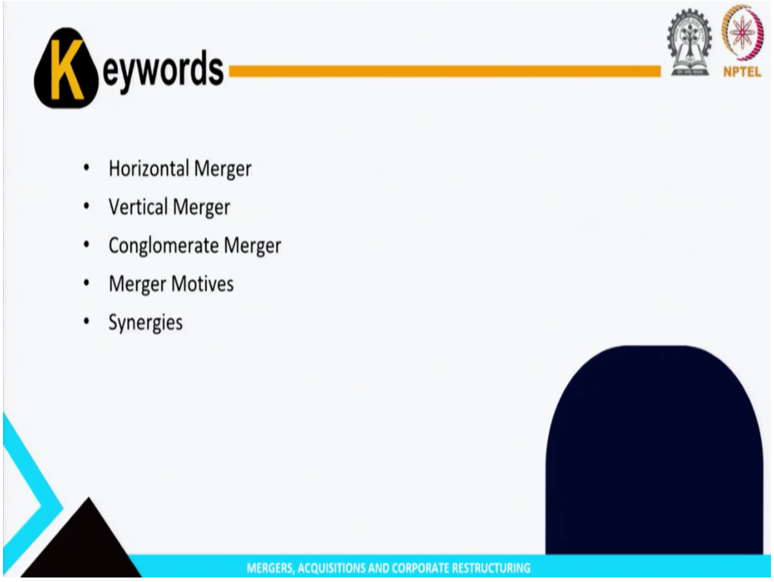

And we will learn about certain keywords like horizontal merger, vertical merger, conglomerate, merger motives, concept or synergies. These are anyway there are several other terms also various interested terms could be there in the session, but these five keywords are being put up here. Coming to the different types of mergers as such.

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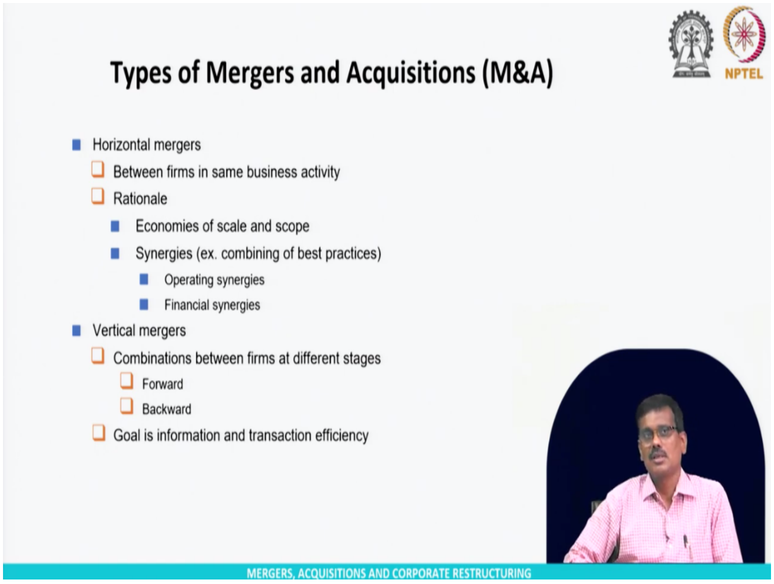

So, we talked about in the previous class yes merger lead to expansion and if the mergers or company are happening in similar sector that is where related diversification, related merger or related acquisition and related acquisition could be horizontal or vertical. Horizontal means in the two companies in the same business line activity and they come together and for example you had Tata Steel taking over Bhushan Steel.

Of course Bhushan Steel was become a takeover candidate because it has referred to bankruptcy. So, instead of closing the company the bankruptcy regulator failed they could find that yes some other company can takeover. So, a steel company like Tata Steel is taking over another steel company called Bhushan Steel. This is called your horizontal diversification that means same type of products as such.

You have another example of recently again this could be because of problem in a particular sector like telecom sector had a lot of churning, lot of problem sometime back. So, Vodafone and Idea thought of merging together and becoming a bigger player as such so that they can compete against Reliance Jio which was newly introduced and also the Airtel. So, that could be another example of horizontal merger where both the companies are having same operation and they are just joining together and expanding their market space.

Yes, what could be the reason for that? Yes there could be that there is lot of economy as a scale that means same product offered to multiple people, multiple customers and there could be some products which is not in product company A or in company B. So, that case the company B's customer will have now access to same companies different products as such that is another scope.

That means you are introducing combinedly you are having more products than individual that you are selling or providing a services as such and another reason why they go for is that yes there could be because of synergies like operating synergies and operating synergies means you are reducing the cost of the company that means cost for production or selling one unit is going to be lower that is expected to be lower or you can also revenue enhancement that means on both.

Revenue enhancement can be there, cost reduction can be there, revenue enhancement means we discussed because of economies of scale and scope so you are selling more together instead of individually selling whatever you are selling then you can also have because of financial synergy of course these two things will revisit when you will discuss in the subsequent session about the theories of mergers, acquisition.

We will revisit them, but still because we are talking about why horizontal merger could take place of course operating synergies, financial synergies can be applicable in case of vertical mergers. If not necessary it is only exclusive to the horizontal merger as such. Mostly in operating synergy talk about scale is higher, cost of production selling which means lower as such that could be motive as such or merger as such.

Vertical merger what happens in a value chain because at the end of the company has a value chain from starting on the upward could be the forward could be the customer till the source of raw material. So, in this value chain if you have a three, four players are there and you are one of them so you may acquire a company in the value chain either forward or backward, for example, a steel company can think of acquiring an iron ore company because iron ore is the input for steel.

So, earlier steel company was going to invite quotes for supplying iron to them. Now instead of that have; their own iron ore. So, what happens they do not have to go for multiple transactions because this own company which is going to supply iron ore for their steel production that is called vertical merger in a backward integration. Similarly, for example, Apple purchased or took over the company on a semiconductor company that is your dialogue semiconductor European company from 300 million dollar sometime back.

So, Apple needs the chips or semi conduct for their; its products. So, instead of going for different suppliers they typically as if they bought the supplier itself. So, now they have the less uncertainty as far as sourcing of metal is concerned because the source of material as per some parts of semiconductor is now taken care; by the acquired company for that matter. So, that is could be the example of vertical merger.

So, vertical merger could be both forward as well as backward. Forward means yes, for example, a supplier acquiring a customer could be taken as a forward merger whereas supplier being acquired by the customer will be taken as a backward merger as such. What happens this leads to lot of information efficiency as well as transaction efficiency and that indirectly leads to cost reduction in the company.

And cost reduction leads to better margin and better margin can lead to better appreciation by the market as well. So, at the end of the day companies are pressured for the revenue enhancement, companies are pressured for cost reduction. So, with this type of merger acquisition company can possibly achieve one of them or both of these goals revenue enhancement as well as cost reduction.

And it can be rewarded by the market in terms of better market price that is an expectation actual market may react differently. It is also told that most of the merger acquisition not rewarded with market, there are different article, different researches. Some people say M and A is beneficial, some people say M and A is not beneficial from this shareholders point of view.

We also see a term called winner (()) (08:20) the acquiring company actually loses out companies with target companies that is also possible, but anyway merger acquisition going to happen, going to take place and these are different types talking about horizontal merger, vertical merger. So, we have also different other classification mergers and acquisitions.

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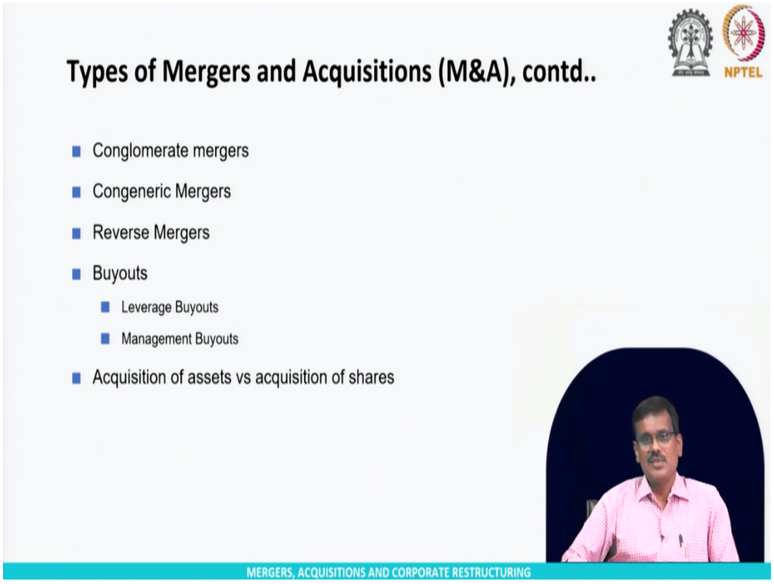

We have another called conglomerate merger. Conglomerate mergers means the company is into a particular industry, but they diversify an absolutely on related industry. In the previous session you are talking about Reliance Industries taking over Urban Ladder. Reliance Industries is into petroleum, textiles now Reliance Jio, they are also now going for Reliance Jio in market.

So, if you look at Reliance as a company point of view is a conglomerate because there are several industries in one company itself. Similarly, you can also have an example of Tata Group; Tata Group is also conglomerate. So, in Tata Group has acquired BigBasket for their expansion online retail space. So, online retail space point of view it is a related diversification, but Tata Group point of view it has become a conglomerate.

So, Tata being known for steel and automobile also the TCS for that matter, it is entering into retail space online and offline that looks to any conglomerate. So, when we acquired some businesses which are not related to the core activity we can say that conglomerate diversification. So, there is also an argument that possibly conglomerate is not good for the company, from the shareholders point of view.

But still companies go for expansion and conglomerate mergers is a fact these days because the people say that by being a conglomerate you are sending a confusing signal to the stakeholders. Stakeholder or a shareholder do not know what is this business? This business is in product X or industry X and industry Y irrespective of that conglomerates are happening.

Conglomerate is taking place and there you can see day-to-day life there are several companies becoming conglomerate over. Birla Group we can say all the business groups in India can be taken as an example of conglomerate as such. Standalone there is no relation between two companies, for example, Tata Motors and TCS there is no relationship. So, from Tata Group point of view it is a conglomerate.

So, they serve the business in IT sectors as well as automobile sectors as well as steels and several and chemical and all those things are there. So, from the group point of view it is a conglomerate. So, there could be some merger taking place by a company and the target the acquired company may not have any relationship with the acquiring company neither in terms of expansion or products nor in terms of expansion in the value chain called vertical either forward or backward that is something.

Then we have an interesting term or merger called congeneric merger. It is like combination of conglomerate and generic. Generic it is known because the company that is acquired or merged are in same overall sector in the term. So, that the customer could be same type customers whereas the products that they offer could be distinct and if those two companies in the related sector, but two distinct products taking place that is called congeneric merge.

For example a hotel company or a hotel industry can acquire a travel company or travel industry company in that case travel industry and hotel industry both of them cater the needs of the tourist because the customers are same. Same customer goes to company X for tickets and tourism booking itself and the same customer also goes to company Y for hotel, logging and boarding.

So, instead of that the one company can give both the services then same customer comes with one company only. So, hotel industry has its own dynamism, tourism called travel has another dynamism they may not be similar of course they could be affected by similar sector, similarly industry condition or (()) (12:46) conditions, but there are two distinct segment as such.

So, when they come together that could be taken as a congeneric merger. Another example that we saw recently in 2018-2019 the Capital First which is non banking finance company being merged with IDFC Bank. So, IDFC Bank has savings and current accounts, loans, retail loans etcetera, housing loan etcetera customers are there whereas Capital First is not a banking business.

So, the customers could be same this sector is financial market, but the products are distinct. One is NBFC product another is your banking products. So, they come together and same customer one customer of existing customer of let us say Capital First now has access to the banking products of the IDFC Bank. Now it is known as IDFC First Bank. So, that is an example of congeneric.

Why generic? Because both of them belong to financial market segment why conglomerate? Because the customers are different, the products are actually unique when the companies are together as such. Then you have another example, another out of mergers called reverse merger, but mostly what you observe in merger acquisition a bigger company acquiring is smaller company that is mostly we observe.

The acquiring company is bigger than the target company, but there are cases where the small companies acquiring bigger companies and mostly it happens to the group as such, as an example quite a long time back ICICI Bank was set up by the subsidiary of ICICI Industrial

Credit and Investment Corporation of India that time a development bank because in the deregulation it took place ICICI floated bank called ICICI Bank.

So, subsequently what will happens ICICI is into long term finance, infrastructure finance. ICICI Bank is into the retail segment banking, asset, current assets, savings accounts, housing loans all those things are there and the later it found that ICICI Bank had lot of prominence, lot of presence and there was no purpose of having ICICI separately from ICICI Bank. So, in that case what happened although one expected the ICICI which was the holding company or the owner of ICICI Bank to takeover.

But actually ICICI Bank took over ICICI and then it became ICICI Bank. So, that is a case of reverse merger. So, we say either a small company takeover bigger company or generally a subsidiary company is taking over the holding company then becoming bigger is called reverse merger. The motives of merger could be same as you discussed earlier economies of scale, economies of scope, less transaction cost, less releasing in this particular case.

Like merging two companies at the same group they also lead to less bureaucracy because the people would have to report two management now one management is enough for that matter and also lot of transaction efficiency could be there in the merger of two different companies in same group can take place then although it is another company here is a buyout although, it is same thing like takeover no doubt about that.

But more discussion is warranted here because buyout is like takeover buying out a company and if this particular buyout is financed more by loan that is called leverage buyouts. So, there are several leverage buyouts are taking place recently and, for example, when the Tata Corus deal took place it was another example of leverage buyouts because lot of debt was taken by Tata Group to allow this particular company.

But the first formal leverage documented buyout I will not say formal it is a documented buyout could be Tetley the international the tea company being taken over by small company like a Tata Tea and the Tata Tea took over Tetley; Tetley was couple of times bigger than Tata Tea. A bigger company could be acquired by the smaller company Tata Tea and Tata Tea finance this particular deal with the help of lot of debt.

Almost more than 60%, 70% the amount required for the acquisition was through loan. So, this can be taken as a leverage buyout. So, you are buying out a company with the help of lot of debts, substantial debt that is called the leverage buyout and if the same buyout whether leverage buyout or the (()) (17:42) buyout the same buyout is executed by the existing management of the company that means management is other than the owners of the company in that case.

And owner will like to exit and management people will say no we can continue this business in that case that is called management buyout and the management buyout could be the existing management can buy these shares in the company by paying cash to the existing owners and that money that they require could be taken as a loan. So, it could be leverage buyout executed by this existing management that is called management buyout as such.

And example could be that we discussed like the Capital First and the IDFC Bank got merged earlier, so that was discussed in the context of congeneric merger. In fact, the Capital First is earlier was a another group company in Futures Group the Kishore Biyani Group and that company was subsequently taken over by the management Mr. Vaidyanathan who was the CEO of the company.

He took over the group company the NBFC Group arm of the Futures Group and converted renamed it as a Capital First that could be taken as an example management buyout in India and subsequently anyway this particular company also got merged with IDFC Bank to form a congeneric merger like IDFC First. Then you have other acquisitions also it is not necessary that you acquire the shares of the company.

Companies can also acquire assets instead of acquiring shares. So, when you acquire shares then you acquire the company management if people all those things are there, but when you acquire assets you have to just bother about the condition of the asset and buy the asset as such that is called acquisition of assets versus acquisition of shares. So, whatever serves the purpose for you can go for that, we can acquire assets or acquire a share of the company also.

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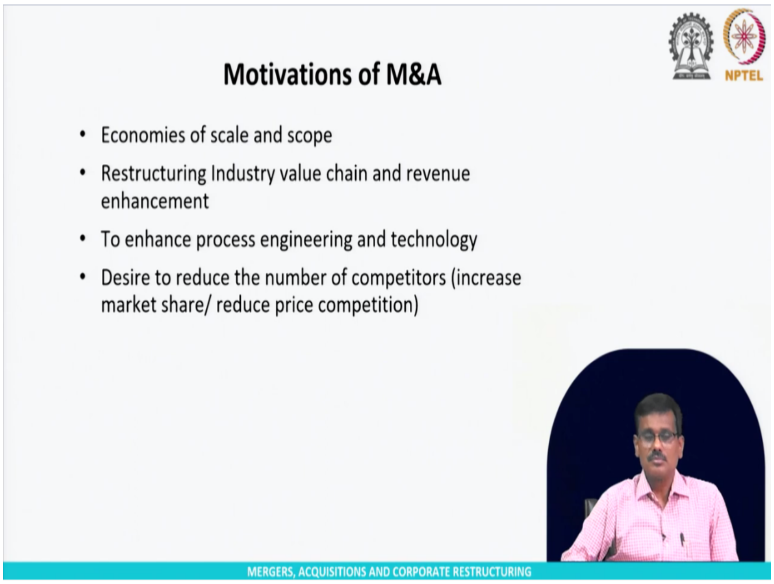

Then next we go for what could be the driving force for M and A happening? Of course, we discussed sometime back in previous session also what could be the motives also like you talked when you are discussing horizontal merger we talked about economies of scale and scope. Yes that could be the major motive that I want to expand my market, expand my customer base, expand my technology, expand my platform and offer new, new things to that.

So, that is enhancing my economies of scale and economies of scope. Another thing is that I restruct the value chain, I acquire a customer or I acquire a supplier in that case I enhance my revenue. So, an industry will go out to lot of restructuring and because I acquire a company and I go for more and more acquisitions then I need to enhance my processing abilities. I want to augment my technology.

So, I will acquire a company which is good at technology. So, that way I do not have to develop the technology, wait for the time to help me rather I buy a company which has got lot of technology in place and that company has the benefit of coming to merge, merging is another company which has got lot of scale and scope as such that is what could be my motive also.

Then yes anyone will like to reduce the number of competitors or will like to increase the market share, reduce the price competition so that you can offer a better price, but at the same time this particular type of mergers, acquisition where your intention is to reduce the competitors that means customers are going to have less choice. So, in that case possibly the regulator which is Competition, Commission of India may not approve this merger because they may seek that the number of players are lesser.

Customers have lesser choice if in fact the suppliers also have a lesser choice. You will have bargaining power with supplier, we also going to have a lot of bargaining power with respect to customers. So, both the parties in the value chain customer as well as supplier are going to have limited space to operate and they may be dictated by the bigger or combined entities. So, in that case I may have aspire to acquire a company because bigger, but the regulator actually may not approve as such.

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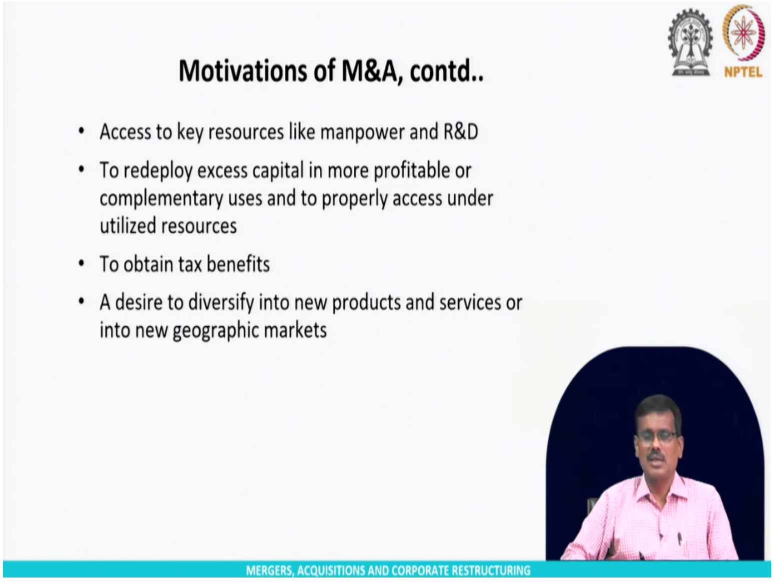

Then yes other motives are also there that is some companies will like to have key manpower. So, there are companies which are good at let us say pharmaceutical company. They have the major driver of pharmaceutical company could be the scientist working in the company and the R and D taking place. So, one company may acquire another company and one pharmaceutical company may acquire another pharmaceutical company because that other pharmaceutical company has lot of key resources for a pharmaceutical sectors.

That could be in terms of good manpower, good scientists or so good R and D facilities because pharmaceutical company have to continue to develop new-new formula, new-new, drugs and it takes a lot of time to do that as such, but there could be some companies which is good at research and development so I acquire that particular company for that matter. So; because I have an access to good manpower and R and D for that matter.

Then I may look for redeployed my capital for more profitable and company (()) (23:52). So, I have underutilized resources, I have lot of money with me and lot of cash surplus is there, lot of cash flow could be there. Now I have to think of widely because if the cash is there with me or assets are there which are not performing; performing means you do not have alternative use then it can lead to lot of misuse.

So, for that purpose I have to look for alternative avenues where I can actually use that my money and in that acquisition becomes one of the avenue for me so that I can use my cash flow as such that could be another reason of merger and acquisition then there are several cases where maybe loss making company, they have potential to grow, but the existing management is not able to manage and they like to exit.

So, as a profitable company we can always acquire that and because this company is making losses so that loss that can be possibly set off against the profit of my company and in that way what will happen I will have less tax to pay in future, but one caveat is there you should not be acquiring a company only because it is a tax benefit.

That means in that case you are expecting the company to incur losses in future also that is not the purpose here rather there could be some other purpose like the company is into some business, some segment which augment my products, my revenue. The company may have some technology which will also augment my technology. The company may have good resources, key manpower and R and D scientist like that.

So, that is also going to augment my processes so those things have to be there. So, tax benefit could be one added advantage. So, tax benefit should not be the primary motive of merger acquisition that one has to keep in mind that is another one of the caveat also then you have to also desire that same products are now sold. So, I like to go for new products for that matter.

And new products I can introduce new products in the same market, I can enter a new market also or expand by the existing market in new geography. So, all those things are also could be there was the motivation. There are several other reasons of merger, acquisitions happening and in fact they are also known as theories of mergers and acquisitions and theories of mergers and acquisition is the reason behind that.

And we will be discussing about theory of mergers and acquisitions in subsequent sessions. Coming back to that previous point where you talk about synergies as such where another motive is that we talked about operating synergies we also talked about financial synergy. In financial synergy what happens that a company becomes bigger and the two companies join together such become bigger.

They will have bigger bargaining power with a financial. So, they may be able to raise finances at a lower cost of capital. So, lower cost of capital leads to better profitability for the company and better market because cost capital reduces possibly we are able to command a better market price in the market also and not only that you will be able to get lesser cost of debt.

You will also be able to get more debt because you are now become bigger also. So, that is what also something which you have to discuss that yes financial synergy along with operating synergies would be there and financial synergy typically is in terms of reducing the cost of capital and when you go for bigger finances with the financial obviously the (()) (28:08) on the transaction cost of raising financial is also going to lower.

So, that is also indirectly going to lower the cost of capital. So, what in this particular session we discussed about the different types of mergers like conglomerate, congeneric, horizontal, vertical from the business expansion point of view we also talked about what motivates the company to go for more and more mergers and acquisitions both expansion in a product, market, financial benefits, synergies all these are being discussed about.

In the subsequent session we will take some example, some more example also we will talk about whatever I have discussed in the merger motive, we will also talk about proper theoretical aspect like in financial theory also mergers and acquisitions theories are there, same thing we will revisit in terms of different theory as such and last point you talk about the merger motive.

The mergers can simply happen because hubris up the management, the management just thinks that I like to go for more merger and acquisition. We will talk more about that in the subsequent session. Thank you.