Strategic Management - The Competitive Edge
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Lecture 33
Mergers & Acquisitions

So, in the last session, we looked at diversification, we looked at the balanced scorecard. So, with respect to diversification, we looked at related diversification, unrelated diversification, we looked at several examples from the Indian context. So, now, we come to one important area with respect to strategic management that is Mergers and Acquisitions.

This mergers and acquisitions I have discussed in my Strategic Management book-the Indian context in chapter number 9 page number 158. This is not something new, if you really look at it in Indian context. It started in the 80s only there was a big fight between DCM and Escorts. So, they were locked in a takeover tangle in the early 80s.

So, compared at that point of time, there was a lot of hue and cry, why this takeover is taking place, could they not operate as distinct units. Why should one take over the other? So, this was something which was not heard of or which was not very common in the early 80s.

Now, fast forward to 2022. It is a common place, mergers and acquisitions keep on happening continuously, whether you are an IT firm or a manufacturing firm does not really matter. So, many acquisitions have been done by IT companies whether it is Wipro, or Infosys; they have acquired so many foreign companies as well.

As I mentioned in the previous classes, it is your reserves position which helps you to take these types of decisions. So, this in the present day setup, what is happening, mergers and acquisitions are considered a strategic option for the company. So, you are to consider mergers and acquisitions as an available strategic option if you have the wherewithal that is your financial resources or such that you can have a leeway with this option, that is what many of the successful IT companies in India are doing now.

So, not only are they trying to look at mergers and acquisitions, commonly known as M&A within India, but they are looking at it actively outside the country as well. So, you find many IT companies taking over many of the companies operating in the United States and Europe. So, this was something unthinkable a few decades back, but now a reality; these companies are taken over by Indian companies and they are operating these units which are functioning from abroad.

So, this is the present day scenario. And merger refers to when two or more companies, I am reading from the book, roughly have the same size or strength formally submerge their corporate identities into a single one in a friendly atmosphere. So, in merger you really do not have a fight.

A holding company may be formed and its shares are exchanged for shares held by the shareholders of the merging companies. This is what happened when this company consolidated coffee which was operating in Coorg, merged with Tatas. Tatas wanted to enter coffee business. They were looking for a suitable candidate, which can be acquired. Then this option of consolidated coffee, which was doing very well in Coorg came up. Tatas offered a handsome price for the shares of consolidated coffee to the existing shareholders.

The result was that the existing shareholders transferred their shares to Tatas and consolidated coffee became an outfit from Tatas. So, in a friendly atmosphere this merger took place and Tata coffee is actually coming, earlier Consolidated Coffee. And Coorg is a well-known coffee growing belt in the country known for its tasty coffee along with the Chikmagalur.

What happens in acquisition-when a company offers cash or securities in exchange for the exchange for the majority shares of another company;happens when merger is not agreed upon. When the battle is severe target price may be 100 percent above market price. This is what is happening right now with respect to Twitter. Elon Musk offering a huge price for its shares, so, he wants to take over Twitter, still not taken over.

He is willing to pump in 44 billion dollars at least, the information in the press and the media that was coming, he was willing to pump in 44 billion dollars. Now the latest information is he is having a double rethink on the whole thing. So, whether to go through the whole deal or to withdraw from the deal - that option is also available to him in the American setup. So, he can do it within six month according to the existing rules, that is what the media puts out.

He is having a rethink on this 44 billion dollars, because many of the existing Twitter shareholders were not very happy, but when the price offered was really lucrative, they said, we go with the whole thing.

Now, Musk himself having this rethink option, should I go through this deal or not? Motivation for merger can be: improving economies of scale, gaining managerial expertise, market supremacy, acquiring a new product or a brand name and diversifying the portfolio, reducing risk and borrowing costs, taxation or investment incentives. So, any of these could be reasons for this merger or acquisition. So, improving economies of scale gaining foothold in the new business. Like what Tatas did with respect to their coffee.

So, many of these things keep on happening on a very regular basis in the present day liberalized Indian market. So, you do not really have to look at the US market; it is happening in the Indian market also. So, some things happening in the world leading stock markets will have an impact on the Indian stock market also. So, whether it is the NYSC or the NASDAQ indices, it will affect the BSE and the NSE. So, whether it is a federal Fed policy of the United States or the RBI policy of India both affect both the BSE and the NSE.

Some of this is reflected in the way the indices move in the marketplace. At present, due to the ongoing war between Russia and Ukraine, not seeing the end, what is called uncontrollables. So, Russia thought that Ukraine will surrender within a week. More than 4 months over, Ukraine not surrendering. But it looks like Russia is losing ground in front of a small country, Ukraine. Ukraine is almost destroyed. Bringing to the pre-war level, is a Herculean job.

Now, with so many supports, propping up whether it is from the United States or from the European Union countries, Ukraine is still keeping the war going that has impacted the world in so many ways- the oil prices have shot up many times through the roof.

Similarly, many of these cooking oils or edible oils, their price has also shot up. So, what was 100 rupee oil due to this lack of imports from Ukraine, it has shot up to double the price to nearly 200. So, this affected the Indian market toō and still affecting. This can always happen when situations are not under your control. So, market is not able to control these types of warlike situations.

The next question that comes is how do you screen a candidate for this merger or acquisition, what is the type of screening that you adopt? The screening that you adopt is identify the industries whether it is a medium scale investment or a large scale investment. Select the sectors based on data with respect to sales, turnover, return on investment, market shares, competition, asset turnover etc. Then choose the companies by sales turnover and asset level, determine acquisition cost, cost of acquisition and returns, compare candidates.

Ranking concept of fit, identifying the good ones can be through high market share, growing market, good management system, diversified portfolio, return on investment above benchmark level. So, in other words, what is the type of indicators that you can get? Suppose you are having the financial wherewithal using the screening process, you can get eligible candidates for this acquisition or merger. So, then you can look at the suitability of a proposal.

You can assemble the suitability of a proposal, there are many M&A companies which are well known in the US, now operating in India also. Morgan a well known M&A company, operating in India also. They do the job of what all mentioned - the screening.

Sometimes, these companies also help you source funds through different agencies can be international agencies also for which they charge a success fees, if the whole proposal goes through and you get a loan at a reasonably low interest rate.Suppose you are able to get it from World lending agencies, then the interest rates will be very reasonable sometimes less than 4 percent, then they charge success fee of 1 percent or 2 percent of the project cost. So, the assessing of the suitability of a proposal is dependent on the funds availability, the likely positive synergies, the negative synergies and the weaknesses, whether the timing is appropriate, required style of management available.

There is one important aspect to be looked at. You cannot just take over any company which is operating in a market just because it is in your field of interest. You must find out whether the culture of this company meshes with the existing culture of the parent company; this was a very sharp indicator for Tatas, when they took over Consolidated Coffee. They found that yes no problem the cultures match.

So, then the top management gave a nod for Consolidated Coffee being taken over by Tatas. In order to do this mergers and acquisitions, some valuations have to be done. What are the types of valuations that you do? One is called the P E ratio that is the market price per share divided by the net earnings after tax per share, gives you the P E ratio.

Then, the P E ratio and the EPS that is the market price per share divided by the P E ratio should be compared with balance sheet and profit and loss account. So, you compare the P E ratios and the earnings per share with the balance sheet and the profit and loss accounts. The acquirer should divest loss making operations.

So, this is one thing which the acquirer should do. Use ratio analysis to compare industry average and current ratio you should use to reduce current liabilities.
The average age of debtors- reduce the average age of debtors; using all these revise the balance sheets and the profit and loss account.

Now, incorporate the growth and expectation rates from your organization. Calculate the replacement value of assets. This replacement value of assets is given by this formula 1 minus the age of assets divided by the total economic life of the asset multiplied by the current cost of the asset. It gives you the replacement value of assets- will tell you when you want to acquire a firm, how much can you pay for these assets. So, this is the job of the M&A companies. They are to give the acquirer a holistic picture; what can happen when this type of acquisition takes place.

Then the next aspect that comes in is managing after merger. How do you manage this company after merger. So, if you look at the Indian scene, NRI status is helping in mergers to get out of FERA Foreign Exchange Regulation Act, likely to become dominant in future.

This is given on page number 160 of the book. It gives idea of what is reengineering on page number 161. This reengineering popularized by Michael Hammer. He suggested seven principles that is organizing around outcomes, not specific tasks, output of the process, perform designer persons or a department's job around an objective or outcome instead of a design. This is organizing around outcomes design the persons or departments job around an objective or outcome instead of a single task or a series of tasks.

When you have those who used the output of the process perform it- Make use of the computer based information systems, processes for reengineering, subsume information processing into real work that produces the information. And the fourth one is to treat geographically dispersed resources as though they are centralized. The fifth one being linked parallel activities instead of integrating the results. The sixth one being fixed the decision point where the work is performed and build control into the process. The last one being captured information once and at the source.

So, do use primary data, to get into database. So, this is this reengineering used by many Indian companies also. It is not that the Indian companies did not make use of it. They did make use of this reengineering. They made use of this reengineering to maybe downsize or thin their line maybe the production line or whichever lines required to be pruned.

Instead of calling it downsizing many call it right sizing. So, this is the right sizing for the organizations. Suppose you required some labor to be retrenched. So, you found that 10 people were working and 5 are enough to do that work. So, you are downsizing this 10 workforce to 5.

So, these are some of the things which are crucial in the strategic management process. The present day scenario looks at mergers and acquisitions as a possible strategic option and a continuing tool. So, it is not that you will look at mergers and acquisitions once in a way. No, it is happening on a continual basis in the Indian market.

Now, given this type of scenario, you look at so many options with respect to strategy.

Now, how do we evaluate what all we did and how do we control these actions? So, this leads to evaluation and control. This evaluation and control is one more important aspect with respect to strategy. There you may have to look at the job design in the new setup. We will consider these aspects in the next session. We will stop here. Thank you.