



THE

OCTOBER 2020

# FINANCIAL

A BI-ANNUAL MAGAZINE



# M&A

DELUSIONS OF  
GRANDEUR

From the

# EDITOR'S DESK



The scale and pace of Mergers and Acquisitions activity in India has been remarkable. Like everything else in life, M&A activity has also been disrupted by Covid-19 accelerating changes both technological and human. With expectations of M&A activity picking up in the coming quarters, we take this opportunity to take a pause and weigh in on the whole process with new perspective.

A merger, as we rightly know, realizes value only when the companies are worth more together than when apart. Simply put, 2+2 must be greater than 4. It is like a marriage which is mostly amicable but at times, deciding the boss of the house becomes difficult as it gets difficult to choose who gets to run the company. Many mergers which seem to make economic sense fail because the managers cannot handle the complex task of integrating two firms with different production processes, accounting methods and most importantly, company culture. M&A is "easier said than done." In practice, it is very difficult to acquire a different company and integrate it, actually realize synergies and also turn the acquired company into a profitable division.

Hence, we selected the theme of the magazine as Mergers and Acquisitions: Delusions of Grandeur. Delusions of Grandeur, as we understand it, means a false impression of the importance of the topic in picture. M&A, while it might seem to bring synergy and be the fastest way for a company to grow, fails terribly at times. Wise men say, only fools rush in and this is what we will explore through the magazine.

At Finomenon, the Finance Cell of SBM, NMIMS Mumbai, when the world stopped due to the lockdown and the virus, we did not. While we were stuck at our homes, we decided to make the most of it and organized several workshops and webinars for students of NMIMS, who will be stepping into the financial world. We increased our outreach and took up various initiatives to support students during their summer placements. We helped students stay abreast with news by starting Quarantine Quiz, a huge hit, where a conducted a poll on recent economic events and provided in-depth, insightful explanations. This year, we strive to do better with FinSights where we aim to provide deeper insights into a recent event or topic on a weekly basis. With our article of the month, we try to keep the batch up to date with interesting topics in finance which are rarely talked about. We have conducted various, exciting activities starting from Bean-counters to The Financial, where we saw overwhelming participation. Our student-led investment fund, Samriddhi, released a perceptive research report on Asian Paints and an industry report on the FMCG sector. We hope to continue to add value to all the students and support them to be great future leaders in the finance industry by focusing our attention on providing them with a platform for learning more about the area of finance with ease.

**- Smriti Agarwal**  
**Editorial Head, Finomenon**

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# M&A

## DELUSIONS OF GRANDEUR





# INTRODUCTION

Solving a jigsaw puzzle is a fairly simple piece of task. One just needs to find pieces that fit together and join them. But what if one puts a few disjoint pieces together? The end result becomes a messy picture that serves no purpose. In the world of business, mergers & acquisitions or M&A deals as they are popularly called are probably the biggest jigsaw puzzles. With some of the brightest brains working on each of these deals, it's intuitive to assume that all the pieces of the puzzle fall into place leading to a high rate of success of these deals. Well, apparently not. Almost invariably, every research pegs the rate of failure of M&A deals at somewhere between 50% and 90%. Given that huge amounts of intellectual and financial resources are used to finalize each of these deals, why do we witness such a high rate of failure? To answer this question, we first need to understand why exactly companies pursue an M&A deal.

## So Why Do Companies Merge and Acquire?

Broadly speaking, through an M&A deal, companies either target higher growth by acquiring new products and customers or increased profitability arising from the new strategic opportunities that the deal would unlock. Simply put, the rationale behind each M&A deal is the same - the combined value and performance of the combined entity would be greater than the sum of the individual parts. This is what is popularly known as synergy in an M&A deal.

# THE SAGA OF M&A DEAL FAILURES

An M&A Deal succeeds or makes sense only when there is value creation. In other words, if two companies are worth \$2 each, an M&A deal between them would be termed successful if the value of the combined entity is greater than \$4, the sum of their individual values. Deals where this is not the case are the deals that are termed as "failed" M&A deals. Losing the focus on the desired objectives, failure to devise a concrete plan with suitable control, and lack of establishing necessary integration processes can lead to the failure of any M&A deal.

Having understood the factors that can lead to the failure of such a deal, now would be a good time to look at a few real-life examples where the M&A deals have fallen apart. Bank of America - Countrywide, Daimler - Chrysler, Ebay - Skype and Mizuho Bank are some of the biggest and the most popular M&A deal failures. In each of these cases a few unique factors gave rise to a domino effect that ultimately doomed the deal.



## Bank of America - Countrywide (2007)

In August 2007, through an investment of \$2 billion, Bank of America started the acquisition of Countrywide. This was at a time when crashing credit markets had spurred rumours that Countrywide could face bankruptcy. On January 11, 2008, it announced its plan to buy Countrywide for about \$4 billion in stock. By the time the deal closed six months later, the price had slipped to \$2.5 billion. At that time, Bank of America was growing fast through acquisitions and was keen on expanding its mortgage business by acquiring Countrywide at attractive valuations. By acquiring Countrywide, it hoped to achieve more growth due to the ensuing synergies. However, soon the deal turned sour and today, many term it as the 'worst deal in the history of the financial services industry'. With everything looking lucrative on the papers, what actually went wrong?

At that time the housing markets were already collapsing but the financial crisis of 2008 hadn't fully unleashed itself yet. Many of Countrywide's loans had gone to people who couldn't afford them, and with the housing market in turmoil, a flood of foreclosures was coming its way. With the acquisition of Countrywide, Bank of America also acquired the legacy of Countrywide's bad practices. Naturally, the bank had to face the consequences of the misdeeds of Countrywide and were flooded with legal battles for no mistake of their own. By 2009, Bank of America's stock price had fallen by 90% and they had to pay billions of dollars in settlement, including a \$10 billion payment to settle the claims of the mortgage company, Fannie May. In hindsight, the valuation of Countrywide that looked attractive and cheap back in 2007 was actually overvalued given the condition of the assets on its book.



This is a classic case of how an M&A deal can go off the tracks because of faulty valuations and external factors like a global financial crisis.

## Daimler - Chrysler (1998)



In 1998, Daimler, a German auto company and then known as Daimler-Benz signed a deal to merge with American auto company Chrysler. Through the deal, both Chrysler and Daimler aimed for the individual as well as shared benefits. Chrysler expected to boost its position in Europe and gain from the lustre of the German brand among other benefits while Daimler expected to increase operations and manufacturing in the U.S. Additionally, both Daimler and Chrysler would enjoy shared benefits like technology transfer, pricing power and tax savings. The deal was valued at \$36 billion and was met with much fanfare since many analysts felt the synergies would benefit the companies tremendously. The estimates of the analysts were clearly off the mark since eventually, in 2007, Daimler sold its 80% stake in Chrysler for just \$7.4 billion and the remaining in 2009.

At the heart of this deal failure was the issue of cultural integration. The 2 companies were not only different in terms of their nationalities but also in terms of their culture. Chrysler, being an American company had a loose, entrepreneurial culture while Daimler, being a German company, had a much more rigid and hierarchical organization. Needless to say, there were often cultural clashes between the German and American managers. There are multiple accounts of the cultural clashes and according to one such account, the new executive team removed the smoke detectors at the Detroit Headquarter of Chrysler so that they could smoke cigars in the evening. Apart from cultural integration issues, there were other issues too which hampered the deal. The deal was portrayed as a merger of equals from the outset but in reality, Daimler wielded greater influence and power which became a flashpoint. Further, mismanagement at the top led to lower-level managers losing traction and often conflicting with each other. Finally, Chrysler's top talents left the company after the deal which proved to be another nail in the coffin for the deal.

This shows how cultural mismatch and lack of leadership can ruin a merger even if significant financial and product synergies exist.

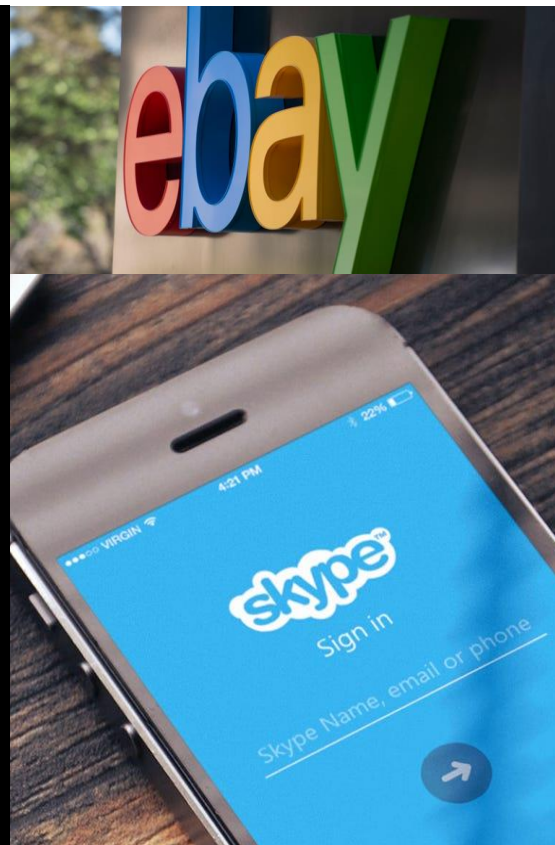


## eBay - Skype (2005)

In 2005, Skype was one of the most exciting tech companies with VoIP being one of the most promising technologies back then. eBay Inc. purchased Skype for \$2.6 million. Many considered this to be an extremely high price for eBay since it had only \$7 million in revenue. However, eBay believed the synergies justified the price. eBay believed its site would be improved with Skype since it would provide a better interface for its users to interact. However, 2 years later eBay announced that it would write down the value of Skype by \$900 millions. Keeping aside the fact that eBay had a higher bid from Microsoft, the point remains that the eBay-Skype deal never really succeeded.

The primary reason why eBay bought Skype was to improve the user experience of its site through Skype. However, the users of eBay rejected Skype since they felt Skype was not necessary for eBay's main offering i.e. auctions. Thus, the entire rationale for the deal disappeared. Additionally, the cultures of both companies weren't perfectly compatible. While eBay had a much more formal culture, Skype had a new-age culture that promoted democratization of the workplace. Thus, cultural integration proved to be a challenge as well.

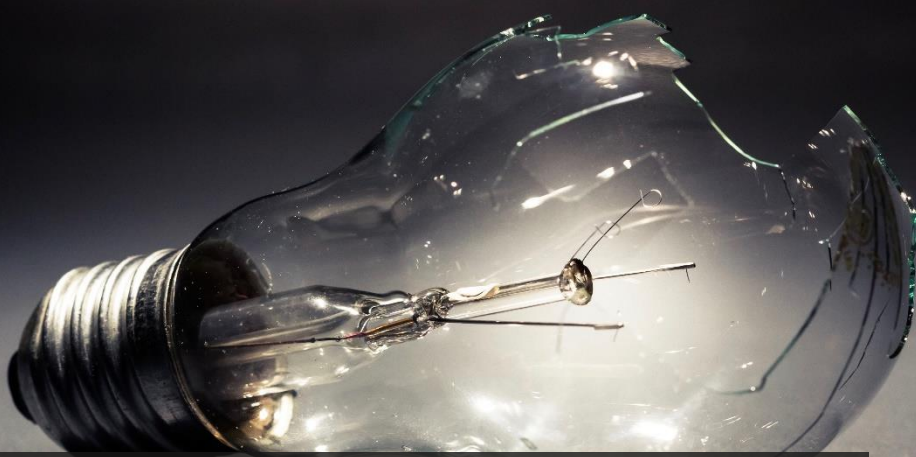
**The eBay and Skype deal is a perfect example of how an M&A deal can go haywire and stop making sense due to erroneous estimation of customer's demand and a poor integration process.**



## Mizuho Bank (2002)

In 2002, three of Japan's largest banks combined to form Mizuho Bank with assets worth ¥2.5 trillion which was more than twice that of the then world leader Deutsche Bank. It was expected that the merger will result in a new era of cutting-edge comprehensive financial services by making use of the group's strengths backed by a powerful customer base and state-of-the-art financial and information technology. With an investment of ¥130 billion, it was expected to give future benefits of ¥466 billion a year, making the deal extremely lucrative. However, the problem started when news made rounds that squabbles among the three partners had begun and one major concern was IT. There was a different computer system supplier which each bank had and instead of merging it to a common one, they decided to connect the three using "relay" computers. When the company started its operations after three years of its initial announcement, they faced computer glitches and within five days had a spectacular foul-up. Around 7,000 of the bank's cash machines did not work, 60,000 accounts were debited twice for the same transaction, and millions of bills went unpaid. It was also reported that the biggest gas company, Tokyo Gas, was missing ¥2.2 billion in payments even after two weeks and the top telephone company, NTT, was forced to send its customers receipts due for ¥12.7 billion marked with asterisks in place of figures since it did not know which of about 760,000 had been paid. Thus, what conspired clearly showed that the companies which came together to exploit the synergy of economies in its IT systems, fell apart due to the very same reason. This fiasco perfectly demonstrates how prediction of mergers are easier said than done and the very synergy which looks lucrative can fall apart, like that of leveraging the IT systems in this case.





## OTHER REASONS FOR FAILURE

As seen from the above examples, M&A deals can fail due to faulty valuations, erroneous estimations of customer demands, external factors, and cultural integration problems. However, apart from these, there are a variety of other reasons which can derail an M&A deal.

Appointing M&A advisors by any mid to large-size deal is almost mandatory but leaving everything to them results in failure. Thus, Owners should be involved in the entire process of the deal since limited owner involvement has derailed many M&A deals in the past. Further, an important process of post-merger is the integration of the parties involved. However, the disintegration related to various factors such as important processes, crucial projects, sensitive matters, key employees lead to failure in the execution process.

Another aspect that companies forget to take into consideration is the cost they would incur to undergo this process. The companies often fail to recover the high costs leading to an unsuccessful deal. At the end of the day, mergers & acquisitions are deals that are based on assumptions, and negotiation skills are one of the most underrated aspects of the deal. Companies often fail to appreciate the fact that improper negotiations can lead to unintended consequences that can make or break a deal.



## WRAPPING UP

On the surface, an M&A deal looks like a simple transaction between companies coming together or one acquiring the other but what often goes unnoticed are multitude of factors that play a role in making these transactions happen. As a complex transaction, it has many potential problems and pitfalls. Many of these problems arise in the initial stages such as misvaluations, misleading planning, limited owner involvement; while some arise because of the post-merger integration issues between the firms involved. Also, stakeholder's concerns in the post M&A process can cause problems due to restructured responsibilities and diminished power.

The consequences of an M&A failure or deal abandonment can be severe, affecting the reputation and share prices of both the parties involved. However, business owners, advisors along with all the associated participants should be careful about the possible pitfalls. In conclusion, to perfectly finish a jigsaw puzzle each piece would play an important role and its diligent screening would always increase the odds of success.

*- Aritra Banerjee, Aarushi Alagh & Nimisha Bhagat  
Editorial Team, Finomenon*





# The Art of MEGA-DEAL

They say **‘Think bigger and better’**. But is it the same in the world of mergers and acquisitions? To examine this statement further, let’s look at mega-deals. What is a mega-deal? A mega-deal is a merger or acquisition valued at \$10 billion or more. But it is not just the size of the deal that makes it different from any regular M&A deal. It is the name of the companies involved and the significance and complexity of the transaction that generates an absolute buzz in the market. It’s the ‘Big news’ that immediately grabs the attention of the investors and customers and sends the competitors into a frenzy. Now why are mega-deals so popular? We have seen a trend where despite the jitters in the economy, Mega-deals have actually

grown in size. In 2011, mega-deals grew five times as fast as the overall M&A market. Some of the biggest mega-deals have taken place during the pandemic. One of them being the Nvidia acquiring the UK chipmaker Arm from SoftBank for a sum of \$40 billion. So there could be a number of reasons why management goes for mega-deals. They could be seeking to be transformative in their industry and fasten their growth prospects which a typical M&A transaction might not be able to provide. They could be looking to acquire a new technology or a highly valuable asset instead of developing one on their own. This helps them in reducing their R&D costs. For example, Salesforce acquired Tableau for 15.7 billion last year to mainly get a stronghold on the data analytics and

want to generate extra returns from it. data visualization technologies. They also got access to the large customer base of Tableau through this deal. Some companies also acquire their competitors via a mega-deal in order to gain more market share and eliminate competition. For this reason they often trigger antitrust scrutiny. Recently Facebook, Google, Amazon and Apple have been under the radar of the government for the very same reason. Many companies even go for bigger deals when they have a lot of cash lying in their balance sheets.

This brings me to another important point, the financing of the deal. The company could go for either stock, cash, debt or a combination of the three to finance the deal. Because of the huge amount of investment involved, the complexities, media and government scrutiny, that come along with the deal, it is not only important that the deal makes strategic sense but it is also important how it is sourced and structured.

For this very reason, managing and executing a mega-deal is an art that needs to be mastered. Mega-deals and deals in general are not just about complex algorithms, it involves coming up with creative solutions to the numerous complexities that come in the way, skillful negotiation and excellent leadership skills. A single deal could take more than a year to implement. In spite of all the planning, these deals often fail. In the world of M&A, where a merger could be compared to a marriage, a mega-deal to a Big fat Indian Wedding, their failures could be compared to the marriages that end up in a divorce. What are some of the pitfalls that lead to their failure and is there a way we could avoid them from falling apart? Let's look at some of the pitfalls and how one could possibly avoid them.

***In the famous case of Amazon and Whole Foods where Amazon had acquired Whole Foods in 2017, we see a classic example of a cultural mismatch.***



## ***Cultural Mismatch***

While integrating two organizations, one of the most important factors to look at is the cultural aspect and the people who make the organizations. In the famous case of Amazon and Whole Foods where Amazon had acquired Whole Foods in 2017, we see a classic example of a cultural mismatch. The CEO of Whole Foods had initially described the partnership as **'love at first sight'** however this love did not last long. Whole Foods employees were extremely unhappy with the new arrangement, the reason being the clash in the cultures of Amazon and Whole Foods. While Amazon had a performance-driven work environment that focused on efficiency, cost-cutting measures and discipline, Whole Foods had an environment where it empowered its employees and gave them the autonomy to make decisions. The new inventory system of Amazon and the scorecards used to evaluate the Whole Foods employees and to ultimately terminate them came as a shock to the Whole Foods employees. This not only led to many employees leaving the company but also resulted in angry customers as the stores were poorly stocked. It's 2020 and the problem continues. Whole Foods employees recently planned a strike after Amazon failed to protect its employees amidst the pandemic.



# ***M&A GRAVEYARD***

## ***common pitfalls and how to avoid them***

### ***How to avoid this mismatch-***

Cultural Negotiation- While negotiating the terms of the contract, it is important to look at the cultural alignment of the two companies and the opportunities and the threats that would exist for the firm due to the cultural differences. A correct balance between the cultures of the two organizations is important to avoid any clashes in the future. Just like for marriage, a prenup could be constructed before the deal takes place to ensure the cultural integration of two organizations after assessing the strengths and weaknesses of each of the companies. In this particular case, the management could have looked at structured empowerment where the company standardizes operations but gives the employees the autonomy to make their own decisions in key matters involving the customers.

### ***Not carrying out proper Due Diligence***

One of the major mistakes that companies make before entering into a deal is that they do not carry out proper due diligence and do not assess all the alternatives before making their decision. One of the deals to feature in the M&A graveyard, the Microsoft and Nokia deal is an example of this pitfall. In 2013, Microsoft acquired Nokia for a sum of \$7.2 billion. With the help of this deal, Microsoft wanted to ramp up its mobile presence. Nokia's existing manufacturing plants, R&D facilities, and distribution channels promised to provide the necessary synergy that Microsoft was seeking. However, Microsoft failed to look at all the possible alternatives. Experts suggested that the deal was overvalued. Microsoft was unable to consolidate its development platform over its OS releases and was therefore unsuccessful in making its Lumia smartphones a success. It had to later sell Nokia for just \$350 million and had to lay off approximately 20,000 employees.

### ***What it could have done-***

Microsoft instead of acquiring Nokia at a higher cost could have manufactured the phones on a contract basis. It could have negotiated the carrier relationship and hired their talent engineers at a much lesser cost. Hence proper assessment of alternatives and due diligence of all the aspects of the company is required before entering into a contract.

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the M&A graveyard, the  
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## ***Ignoring Cross Border Risks***

They say -

### **Distance makes the heart grow fonder.**

However, is it true in all cases? Companies expand their business into different geographies for several reasons- to gain market share, to get the manufacturing done at a lower cost, to fight competition, etc. However while expanding globally, companies need to think about the economic environment and uncertainties and the government regulations of the foreign country.

If we look at the Tata Motors and JLR case, we can see how big an impact Brexit had on its functioning. After the acquisition was made in 2008, the company had a slow start but ultimately started to recover its investment and made profits from JLR. However, in 2016, due to Brexit, the company was severely impacted. Approximately 21% of its revenues for JLR came from the European Union and it imported 50% of its components from the countries in the Union. It, therefore, owed money to several entities in the European Union. Because of the geopolitical tensions, the pound depreciated significantly against the euro. Tata Motors had to face the brunt of this depreciation and faced a loss of Rs.2,300 crores due to currency fluctuations. The uncertainties due to Brexit and the slump in the China sales further impacted the sales of JLR.

This tells us that while global mergers and acquisitions might be successful, there may be times when the companies are exposed to macroeconomic risks which might not be entirely under their control.

### ***Underestimating the time required and the timing of the deal***

Sometimes companies underestimate the time required to complete a deal and the time in which the deal would start showing positive outcomes. As a result, this puts a restriction on the cash flow of the company and delays its operations significantly.

What could be done- Better planning and

strategizing is required to assess when the deal would materialize. According to a Harvard Business Review article, it is important to know when the deal starts generating profits as research has shown that deals with boosted EPS within 2 years beat the market by around 13%, and those that took longer, underperformed the market by 17%. The review also spoke about the importance of the timing of the deals. While it was noticed that around 70% of the deals were finalized during the uptrends however it could be wise to **'Buck the trend'** and enter into a deal during the downtrend as the stock would be more likely to be underpriced and that would reduce the risk of overpaying.

### ***Poor Integration Plan***

Often the companies become so focused on finalizing the deal that they do not think about what happens after the merger. Without proper integration in place, the deal is likely to fall apart.

**How to avoid it-** Start thinking about integration yesterday. An analysis could be carried out to ascertain the pros and cons of the two companies, the key employees, existing problems, bottlenecks in the organization, etc. Integration should be done with the **'big picture'** and with the goals of the deal in mind. It should cover different aspects such as financial, technological, operational as well as cultural differences. Bringing all the employees on board and making sure they are aware of why the deal is taking place and explaining to them their roles in the process would help in retaining their vote of confidence.

One thing is clear, there are definitely more complexities involved in a mega-deal than that which meets the common eye. Although there is no one guidebook for the success of it, the art of megadeals, if mastered, could help a firm in successfully implementing its deal and assuring its success thereafter.

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# INDIA: IS IT MORE CONDUCTIVE TO MERGERS THAN THE REST OF THE WORLD?



In 2016, Tinder recorded 7.5 million matches in a day in India which was the maximum by any country. Since then, there has been a 400% increase in the number of tinder users. Do you think we are digressing? Well, not really. Drawing analogy from the increase in the number of “matches”, we want to drive home the point that currently, India’s environment is conducive not only to dating apps but to the mergers and acquisitions between huge corporations as well.



Since 2019, the global M&A activity has been in a slump. Although it has been strong in terms of value and transaction volume, the overall environment has not been conducive at all. With severe macroeconomic issues like the continuing trade wars between the US and China, tensions in the Middle East, even Brexit to some extent, have hampered cross-border deals. Many investors have adopted strategic domestic megadeals to deal with this. Now, when we add the impact of a pandemic to this chaos, the results are disastrous. It has been projected that mergers and acquisitions (M&A) will decline globally from USD 2.8 trillion in 2019 to USD 2.1 trillion in 2020. The forecast also projected a downward trend in IPO proceeds from an estimated USD 152 billion in 2019 to USD 116 billion, a 23 percent drop.

After analysing the global scenario, now we look at the Indian landscape. Surprisingly, India saw several megadeals, both cross-border and domestic in the year 2019. Indian M&A activity during 2019 surpassed \$67 billion in aggregate deal value. Deal activity was driven by platform deals, portion buyout deals, distressed asset acquisition opportunities, and the continued attractiveness of the technology sector. However, after the onset of COVID-19, India's M&A deals fell to a three-year low of \$38.1 billion in the first half of 2020, a 14.1 percent decline compared to the first half of 2019.

Facebook's stake purchase of 9.99% in Reliance Industries' Jio Platforms is the largest India-involved deal so far this year which brought India's inbound M&A activity to \$17.3 billion, up 1.6 percent from the first half of last year.

However, the situation in India is expected to stabilize in the coming few years, despite the global headwinds. This will be driven by the revival of private investments against the backdrop of a more favourable business environment.



## **M&A downturn due to the pandemic and near-normal recovery**

The Covid-19 pandemic is a humanitarian crisis that continues to damage lives and livelihoods everywhere on Earth. It has shattered regional and national economies across the world, including the Mergers & Acquisitions activity.

**State of the capital markets:** Just as the spread of COVID-19 was accelerating around the world, global equity indices reached historic peaks. The MSCI World, S&P 500, and STOXX Europe 600 indices all closed at record highs on February 19, 2020. However, in a matter of weeks, these benchmarks lost around 30-35% as compared to their February peaks.

The M&A market, naturally, is affected by the deterioration of capital markets and the real economy. As per a report published by McKinsey & Company in July 2020, the market capitalization had declined in India between December 2019 and May 2020 in most sectors, owing to the impact of the Coronavirus pandemic. The pandemic led to the cancellation of several M&A transactions. Ally Financial was forced to abandon its planned \$2.65 billion acquisition of CardWorks in June, while Texas Capital Bank shelved its planned merger with Independent Bank at the end of May. The reason cited was that the economic environment at the time of cancellation was vastly different from the time the deals were announced. After a significant slowdown in April and May, a surge in M&A activity was witnessed over the summer. This slowdown was primarily a temporary pause of current deal activity to allow time to assess the potential market recovery timeline or to delay anticipated deals still at an early deal phase such as a letter of intent or in preliminary due diligence. Hence, Q1 2021 saw an upturn in M&A activity as compared to Q4 2020. July not only represented the strongest month of 2020 but also exceeded average monthly volumes experienced over the prior five-year M&A bull market. Moreover, the crisis has opened buy-side opportunities leveraging on the lower valuations in the short term to seek a higher return on capital in the long term.





Let us look at the following examples to understand the same:

### Reliance-Future Deal

On 29th August 2020, RIL announced that it is acquiring the retail and wholesale business and the logistics and warehousing business of rival Future Group for a cash consideration of Rs 24,713 crore in a deal that is likely to give the oil and telecom conglomerate a stronghold in grocery and apparel segments. This acquisition brings brands like Big Bazaar, Easy Day, and Brand Factory under the flagship of Reliance. Future Group has brought in a strong supply chain and a very deep understanding of the consumer segment in this industry. What forced Kishore Biyani to sell to rival Mukesh Ambani's RIL? One of the reasons for this takeover was the pandemic. The deal took place when retailers, all around the world are struggling to cope up with the decline in business and the challenges caused by COVID-19. Things became worse for Future which had been in bad financial health since the last few years and had a debt of Rs 12,778 crore as of September 2019. As its revenue streams dried up, servicing this debt became impossible. Hence, it had no other option and had to accept RIL's deal as Reliance has agreed to take up the group's debt as part of the deal.

### Uber-Postmates Deal

Here is another deal that has emerged as a result of the pandemic. Uber decided to acquire Postmates, USA's fourth-largest food delivery service for \$2.65 billion in an all-stock transaction. Due to the pandemic, Uber's core business of ride-sharing plunged with revenue falling by 80% in April. Hence, to sail through the pandemic, it decided to focus on UberEats, its food delivery business to sustain. Initially, it had made a deal with GrubHub, another food delivery service but when that deal fell through, it went ahead and acquired Postmates. Food delivery apps have grown tremendously in recent years, but the apps offer very similar services, leading to heavy competition and pressure to keep the fees low. Although more and more people have been using these apps, the profits have been elusive. Hence, in an attempt to increase their market share and reduce costs by gaining scale, Uber decided to acquire Postmates. This deal would give a geographical and demographic advantage to them as they originally catered to different market segments. Also, Postmates has strong relationships with various small and medium-sized restaurants which will further help their cause.



Having already discussed the downfall in M&A activity due to lockdown during the pandemic, and its resurgence, let us look at what the future for the M&A sector looks like:

M&A trends in India post-COVID-19

**1. Consolidation within sectors:** The economic crisis set off by the pandemic is causing economic dislocation. Fissures are appearing in the structure of industry sectors. These could be the early signs of a huge gap between companies with sufficient available funding and those without it. As the economy emerges damaged from the lockdown, the soundness of the former group will probably grow into a significant competitive advantage in available capital, customer relationships, and talent.

**2. Portfolio divestiture and carve-outs:** Several Indian conglomerates have a long-tail portfolio. However, on average, the top three subsidiaries in each conglomerate accounted for at least 70% of the group's EBITDA, whereas the remaining subsidiaries contributed less than 30% and had the most accumulated debt in each group. Before the pandemic, debt-saddled subsidiaries were barely surviving. In the post-COVID context, these subsidiaries will find it even tougher due to the scarcity of capital. However, many of these companies compete in high-growth, nascent areas. They could thrive under different ownership—one that regards them as a core business rather than a side business.

**3. Acquisition of regional companies:** In consumer goods, pharma, and retail, success requires a strong brand, as well as a deep distribution and supply-chain footprint. For such industries, established companies may want to acquire local brands that are very strong in a particular region, state, or other niche markets. The crisis has put liquidity pressure on these smaller companies. In consumer goods, for example, sales of some of them are falling because retailers are rationalizing their assortments and consumers are shifting to online channels. Leaders that acquire these smaller brands could energize them by using existing privileged trade relationships and big production footprints. The parent company could thus improve the acquired brand's value while gaining access to new customers in attractive segments.

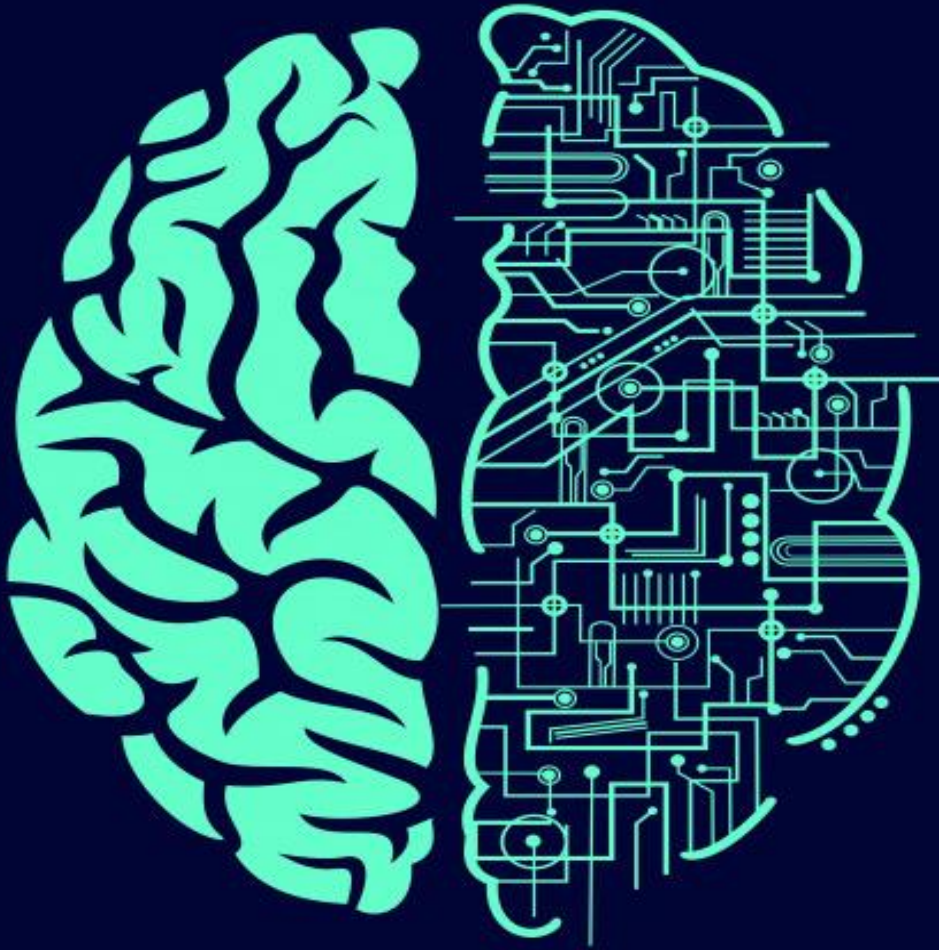
***As the economy emerges damaged from the lockdown, the soundness of the former group will probably grow into a significant competitive advantage in available capital, customer relationships, and talent.***



The recent uptick in the M&A activities is expected to sustain as capital markets stabilize and the deferred IPOs and other transactions get back on track. It is safe to say that post-COVID, India should see a significant rise in the number of deals. Sectors like technology, energy, financial services, and infrastructure are paving the way for private investments. However, the threats of the second wave of Covid-19 still overcast the capital markets. The government policy changes in response to the recent geopolitical tensions can unease foreign investors but going by the focus of the current government of increasing ease of business might allow for cooler heads to prevail with a conducive regulatory environment. A favorable business environment complimenting the immense potential of our demographic dividend will be very attractive to foreign investors and will also serve as motivation for domestic companies to get into such deals.

- Harshita Bhatte & Nitish Sharma  
Editorial Team, Finomenon





# MUSING MASTERMINDS

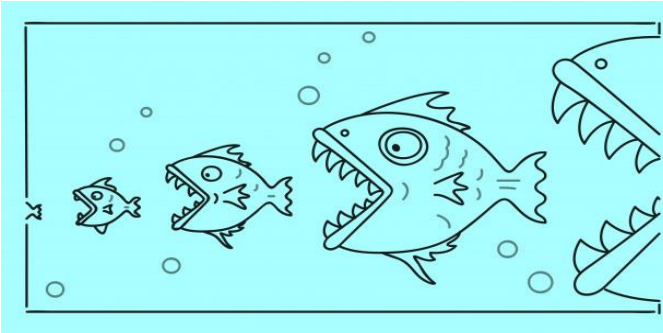
## HUNT FOR THE PERFECT DEAL

Want to know what happens when abundant capital is available at near 0% interest rates or when companies have huge free cash flows? These financial moguls who have access to a huge pool of capital take the inorganic route to drive their growth and increase their technical capabilities. With increased activity in the M&A industry, the complexity of the deals has increased and the need for a perfect investment banker has never been more than what it is now.



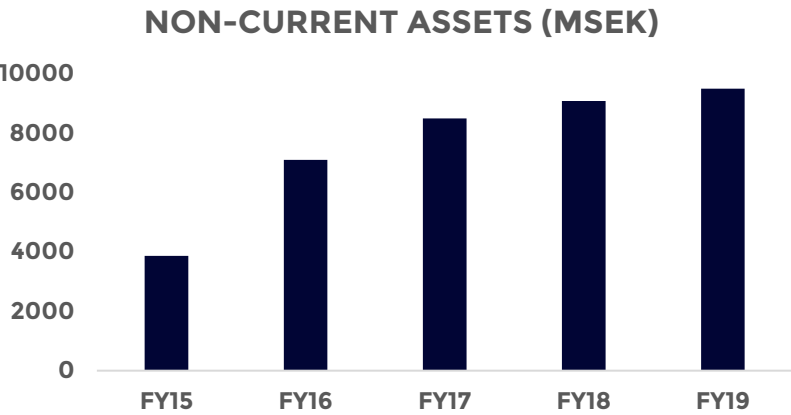
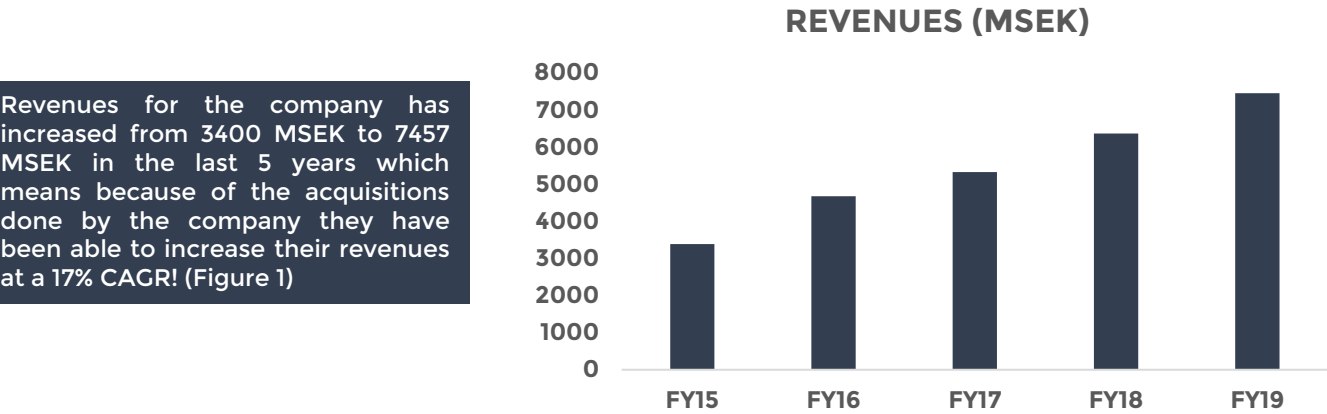
Merger & acquisitions in the DNA-

For some companies, M&A is not a one-time event but it is a part of their strategy. When we look at a company in its mature stage with good cash flows from one of their business verticals the best way for them to increase their capabilities is to acquire a company in the sector they are looking at, to venture into. Mergers significantly reduce the lead time for them and also help them in getting more wallet share from their existing customers. The best way to understand this is through an example.



Recipharm is one of the largest CDMO companies in the world, they help the innovator companies in the pharma industry to outsource their drug development and manufacturing process so that the innovators can focus on what they do best. Recently the sector has been in a lot of limelight and many companies are looking out to outsource their manufacturing and development processes. Innovators look at manufacturers who have vertical and horizontal integration so that they don't have to contact many manufacturers for just one drug. In the case of Recipharm, they are continuously buying firms because each company has unique skill sets and patents which if available to the company will help them streamline their process which will, in turn, help them gain more business from their existing clients. In addition to that, by acquisitions, they avoid the 3-4-year time lag that is required to build the plant and get the necessary approvals. Cross-border acquisitions help the company in gaining advantages that are specific to a particular region, like in the case of India they get a direct cost arbitrage of 50% when compared to any developed nation. Due to their large size and good cash flows, they are able to bring consolidation to the whole industry. They have completed 16 acquisitions to date and have been able to integrate the important patents and the skill set that each of these companies possessed. Generally, in cases where a company is continuously acquiring other smaller companies, the stakeholders have lots of doubts about how well the company can integrate the many new businesses which they have acquired recently. In the case of Recipharm, the shareholders and the board have been extremely happy because these new technical capabilities have helped the company in increasing their EBITDA margins from 13% to 17%.

Revenues for the company has increased from 3400 MSEK to 7457 MSEK in the last 5 years which means because of the acquisitions done by the company they have been able to increase their revenues at a 17% CAGR! (Figure 1)



Non-Current Assets which represent the fixed assets and the intangible assets like goodwill and patents, have increased from 3900 MSEK to 9500 MSEK. This increase is due to acquisitions of patents and drug manufacturing plants done by the company. (Figure 2)

## How are such big deals structured?

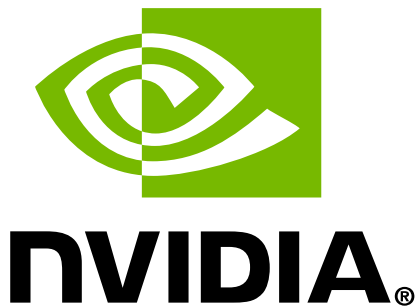
The M&A industry is becoming complex by the day. Earlier when the nature of businesses was conventional the structure of deals was relatively simpler, but now that the business models are getting complex there are new and different ways of valuing a business. Both the business owner and the buyer want to get most of their buck, so to satisfy both the parties the deal structures also have evolved over time.

### Earnout Structure

In an earnout arrangement between a buyer and seller, a portion or all of the purchase price is contingent on the target firm achieving a pre-decided operating or financial goal that is to be achieved post the transaction is closed. In such a structure the business owner will still be interested in the business after the transaction is closed. The business owner can get higher valuations if he negotiates properly and the buyer won't have a problem paying that because he will only have to pay if everything goes as expected. This strategy isn't feasible if the business has to be bought and merged with a bigger business because the performance of the second entity will play a major role in the performance of the target company. This deal structure is getting common these days, recently NVIDIA acquired ARM from SoftBank for 40 billion dollars and out of which 5 billion dollars were payable by NVIDIA to SoftBank under the earnout structure subject to ARM fulfilling certain predetermined targets.

### Special purpose acquisition company

A special purpose acquisition company (SPAC) is a company with no commercial operations and is formed only to pool capital through an IPO to acquire an existing company. These companies are also known as "blank cheque companies". These deals are happening for decades but recently because of active retail participation and interest in private equity SPACs have gone mainstream. To give you an idea of how common SPACs are, in 2020 alone more than 50 SPACs have been formed in the U.S., which have raised a whopping \$21.5 billion. SPACs can also be used to reverse merge a private company to list in the market. ChargePoint which is one of the world's oldest and largest electric vehicle charging networks is nearing a deal to go public through a reverse merger with Switchback Energy Acquisition Corp. Switchback Energy is a special-purpose acquisition company (SPAC) which recently raised \$300 million in an IPO.



### Leveraged Buyout (LBO)

A leveraged buyout (LBO) refers to acquiring another company using a significant amount of debt to pay for the cost of acquisition. This structure of the deal is really common and preferred when the interest rates are low and the business acquired has stable cash flows. In such a case the assets of the company being acquired are used as collateral for the loans, along with the assets of the acquiring company. This is a common way to get a public company private, in some cases the debt to equity used in LBOs can be as high as 9:1.

LBOs can sometimes go southwards and the excessive leverage when combined with a downcycle in the business can act as a ticking bomb for the company.

Tata bought Corus which is a steel manufacturing company in the UK on 23 October 2006 during the peak of the steel industry. They bought Corus for 8 billion dollars out of which almost 6 billion dollars were raised in debt. The bonds of the TATA group were investment-grade bonds, but it was not the case with Corus, the target company that negatively impacted the bond rating of the TATA group. Coming forward to 2014 the steel industry was going through a serious downturn and the TATA group was left with 13 billion in debt. This shows how risky LBO can sometimes be for the balance sheet and the profitability of the company. Debt just magnifies the positive and negative effects.

**Wait.. where does the investment banker come in all this?**

Selecting an investment banker is as important and difficult as finding the right business partner. If you don't get it right you might miss on a lot of things and not get the right valuation for the business you have spent months working on.

The investment banker should have adequate experience given the size of the deal you wish to engage in, if your business is huge and you are looking at valuations crossing 100 million dollars an investment banker who specializes in deal sizes of sub 50 million dollars, will not have the right clients and the skills to get the deal done. If you select a banker who generally does deals for businesses much larger than your business you might not get the right kind of attention from the bank.

You must find an investment banker with adequate experience in your sector. If the investment banker is not aware of the factors that drive valuations for the companies in your sector, then even after having some special differentiation you might end up not getting the deserved valuation. It is even possible that the investment bank might have good relations with some of your possible buyers.

One needs to be extremely comfortable and must clearly understand the payment structure that has been decided with the investment bank. Generally, to show that you are genuinely interested in selling the business, investment bankers charge a monthly fee and when the deal happens, they charge you a flat pre-decided fee or a percentage of the size of the deal. Sometimes the payment structure may affect the valuation that you get for your company.



Another thing which is subjective but very important according to me is the trust and the level of comfort that you have with the investment banking team because you will be spending a lot of hours every day for months to make a sale. To allow the free flow of communication and ideas trust is essential.

### **Regulatory scenario**

Many countries have broad laws that protect consumers and regulate how companies operate their businesses. The goal of these laws is to provide an equal playing field for similar businesses that operate in a specific industry while preventing them from gaining too much power over their competition. Simply put, they stop businesses from playing dirty to make a profit. These are called antitrust laws.

In India regulatory bodies that cover M&A are-

- The Companies Act, 2013
- FEMA (Foreign Exchange Management Act)
- FDI policy
- SEBI by Substantial Acquisitions and Takeovers Act
- IBC
- Competition Act by CCI

In the case of E-com, which is rapidly taking away market share from the small retailers by offering deep discounts, exclusive selling rights and preferential listing of their private labels significantly hurt the profitability and the opportunities of the retailers. In such cases, CCI has to come in to stop the big e-commerce companies to support and encourage an equal playing ground for all the players.



## ***Stock deal vs Cash Deal***

Stock deals are those deals in which the consideration is given by stock of the acquirer and no cash is exchanged compared to cash deals where the acquirer pays the consideration of the deal by cash.

To explain to you why companies which have rich valuations like to do stock deals I will walk you through a really interesting deal that happened back in 2014 when Facebook acquired WhatsApp for \$19 Billion. Back in that day WhatsApp processed 27 billion messages a day, and had 400 million active users a month. Facebook by comparison, had 1.2 billion monthly users - which means that WhatsApp was already, on its own, a sizable threat to Facebook in terms of peeling off its users and siphoning them into a messaging environment that until then, Facebook had no access to.

For years, Facebook had tried to do what WhatsApp already did: It launched Messenger, a standalone messenger app that has had great reviews and maybe 350 million users ... but that didn't slow the growth of WhatsApp. When Facebook paid \$19 billion for a company with no revenues and profits for a product which they already had everyone was perplexed.

Here is a very simplistic way to see how the deal could play out. Facebook was being valued at \$170 billion, at about \$130/user, given their existing user base of 1.25 billion. If the WhatsApp acquisition increased that user base by 160 million (I know that WhatsApp has 450 million users, but since its revenue options are limited as a standalone app, the value proposition here is in incremental Facebook users), and the market continues to price each user at \$130, you will generate an increase in market value of \$20.8 billion.

Out of the \$19 billion \$15 billion was Facebook stock and just \$4 billion was cash paid by Facebook. If later Facebook realized that they have overpaid for WhatsApp but the shares it used on the overpayment were also overpriced

The image shows the word "facebook" in its characteristic lowercase, sans-serif font. The letters are white with a soft, glowing yellow-orange halo effect around them. The background is a dark, vertical-grained wood texture, possibly a door or a wall, with the light from the logo creating a subtle reflection on the surface.

## ***Conclusion***

On the face of it mega deals look like simple transactions but a lot of efforts go around finding the perfect company to acquire, deep research on how this acquisition will increase the synergies and the efficiencies of the acquirer and how important it is to find an ideal investment banker. Innovative deal structures not just benefits the acquirer but also helps the acquiree to get better valuations. With time investment bankers are getting innovative with the deal structures and are creating value for their stakeholders.

- Yogesh Rajesh Shroff  
Editorial Team, Finomenon





If

# MERGING TOWARDS VICTORY

## Using Strategic M&A to Emerge a Winner From the Current Crisis

In early April, when most of the world was in lockdown and sports fans across the globe were distraught due to all games being postponed, a specific section of football supporters was brimming with joy. These supporters had seen their historic club lose its local dominance over the past couple of decades. But the time for domination was back, they thought, as this famous club based out of North East England was subjected to a takeover bid. Newcastle United F.C. or 'The Magpies' as its commonly called, was in for a bright future if this takeover could be completed.

The club had received a £300 million (\$375 million) bid from a consortium of buyers including the Saudi Public Investment Fund (PIF), Amanda

Staveley's PCP Capital Partners, and British businessmen, Reuben brothers, each vying for an 80%, 10%, and 10% stake respectively.

By mid-April, talks were in an advanced stage and football fans around the world were getting ready for another Manchester City and PSG. But M&A's are complicated, and these were no ordinary times. COVID-19 had taken over the world, inflicting infections and deaths in 200+ countries, cutting off global supply chains, and well, postponing (or canceling) exams! This deal was no exception. By late July, the deal had collapsed after the PIF withdrew its bid. The statement they released was as follows:



*“With a deep appreciation for the Newcastle community, we have come to the decision to withdraw our interest in acquiring Newcastle United Football Club. Unfortunately, the prolonged process under the current circumstances coupled with global uncertainty has rendered the potential investment no longer commercially viable”*

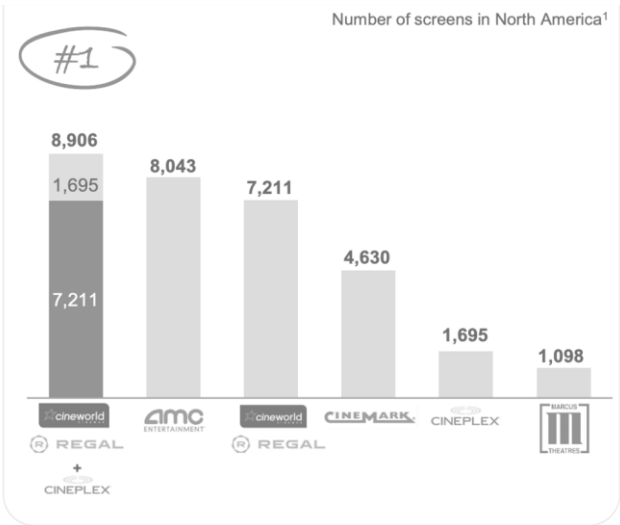
Although there were other factors touted to have influenced this deal, it is fair to assume that the pandemic had a fair role to play.

A more concrete example would be the breakdown of the Cineworld and Cineplex deal. UK Based global cinema chain Cineworld Group PCL had agreed to pay \$34 per share in cash, amounting to a 42% premium for Canada’s largest movie chain, Cineplex Inc., in a friendly takeover bid. The deal was valued at over \$2.5 billion at the time and would have resulted in North America’s largest cinema chain (*Figure 1*). On the next trading day itself, Cineplex shares rose more than 41% (by \$9.87) to \$33.88.

But what was once a ‘friendly’ takeover soon turned into a court battle. Cineworld backed out of the deal claiming “certain breaches” by Cineplex, hence invoking the ‘Material adverse effect’ clause.

However, this piece is not about exploring the legal aspects, so we will stop at that. After Cineworld backed out, Cineplex filed for damages to which Cineworld filed a counterclaim, and now, both parties are fighting in court, with the deal off the table. So much for a friendly deal!

All in all, COVID-19 has triggered a downturn in global M&A deals. In the first half of 2020 itself, Deal volume dropped by 49%, while deal value was down 22% YoY. In addition to the Newcastle and Cineworld deal, several others have fallen through.



Xerox stopped its pursuit of HP, while SoftBank backed away from its planned bailout of WeWork. There have been huge market capitalization losses as well, with Travel & Hospitality losing 49% and the Banking sector losing 31% market cap by April itself (*Figure 2*). Unsurprisingly, some deals that were still being finalized were struck at considerably lower prices. Total price/EBITDA, a key ratio to measure price adequacy in M&A deals, had fallen below seven in March and April (median level usually between 10 and 14).

Figure 1: Largest cinema chains in North America (number of screens) (Jones, 2019)



Why Managers sit tight during such crises?

In such a climate, it is tempting for managers to sit tight and reduce M&A activity. This can be attributed to the following five problems:

- The management might feel they have more important things to cater to. One of the top-most priorities is achieving maximum liquidity, especially at a time when sales and cash flow are rapidly decreasing.
- Similarly, for sectors and companies that benefit from the crisis, managers have to deal with uptake in demand for their products/services (Telecom, Pharma, Video conferencing, etc. in the current case), which means dealing with supply chain expansion and other problems.
- The 'moving target' problem in company valuations. Buyers want great deals, and sellers want to extract the maximum price. But in such a scenario, the former fear overpaying due to the huge uncertainty around the target's future financial prospects and the latter feel that they will be asked to accept an artificially depressed price.
- There are enormous logistical problems created by the inability to travel and hold personal meetings. Although video conferencing has risen over the years, it is still a poor substitute for in-person due diligence.
- Sellers or target companies want quick cash. An M&A deal with a notoriously lengthy process is not really designed for this!



**Travel & Hospitality:** A severe drop in demand with great uncertainty towards recovery could trigger solvency challenges, with potential for consolidations, restructurings and bankruptcies.

**Retail:** Outcomes vary depending on designation of essential versus non-essential, but the impact of consumers sheltering in place is accelerating the trend to eCommerce.

**Consumer Goods:** While the crisis has led to a short-term surge in sales for many, it's also reshaping consumer sentiments in the long term—including preferences for variety, convenience, authenticity and premiumization. This could cause companies to shift their brand portfolios and M&A strategies.



**Energy:** The combination of a drop in demand and the OPEC supply shock sets up potential liquidity needs. This could trigger portfolio divestments and acquisition/consolidation of distressed players.



**Banking & Capital Markets:** Growing pools of troubled/non-performing loans and profitability pressures on net interest margins may trigger asset sales and possible consolidations. The reactions to the 2008 Financial Crisis helped fortify the industry, but the impact of the COVID-19 crisis is still unfolding.



**Life Sciences:** While less exposed to solvency and liquidity impacts, the COVID-19 fallout likely creates new opportunities for virology, supply chain, partnering and virtual healthcare—and a wave of M&A in these areas.

Figure 2: Market Capitalization losses in the first 25 days of the pandemic

It's not all gloomy...

However, the situation also provides opportunities. M&A history suggests that in past downturns, the companies that pursued acquisitions and divestitures in a structured way outperformed their peers. Although the differential varied by sector, it could reach as high as six times over! And if we look at it, certain financial factors do make it possible for well-capitalized companies to revisit their past M&A strategies and make a strategic move. In the Indian context, these include:

**Low debt yields:** Ten-year government securities were at ~5.7 percent in June compared to 7.0 percent a year ago

**Dwindling valuations:** Overall market cap-weighted valuations fell about 1/4<sup>th</sup> from December 2019 to March 2020

**Rising liquidity stress:** More than 60% of top-500 companies had less than 90 days' cash on hand. These are generally true in other countries too

Strategic themes for M&A value addition

So how can companies take advantage? They can do so by identifying and choosing one of the following themes. These can determine the value attainable in particular moves that companies make and, in general, shape their inorganic strategies.

**Intra sector consolidation:** Although the pandemic has caused severe economic damage across the board, some sectors and some firms within the affected sectors have suffered more. Fissures are appearing within sectors as a wider gulf is created between companies with sufficient funds and those without it (Figure 3). As the effects get deeper, this gap will only grow, giving the former group a healthy competitive advantage. This imbalance can subsequently lead to consolidation, with weaker firms being brought off by stronger ones.

**Portfolio Divestitures:** With scarce resources, companies could rush to save their stars and cash cows, hence, leaving non-core sectors unattended. This will necessitate carve-outs and divestitures of these sectors to relevant players.

**Acquiring regional firms:** As the pandemic dries up resources for smaller regional firms, established companies may move to acquire local brands that are strong in particular niches. The leaders can re-energize these brands by using their big production footprints while also gaining new customer segments that were catered to by these smaller firms.



**Alliances and partnerships:** As companies move towards digital channels, nimble companies will want to extend their presence. Alliances for sharing customers, data, and cross-selling will provide lifelines for these companies to stay relevant.

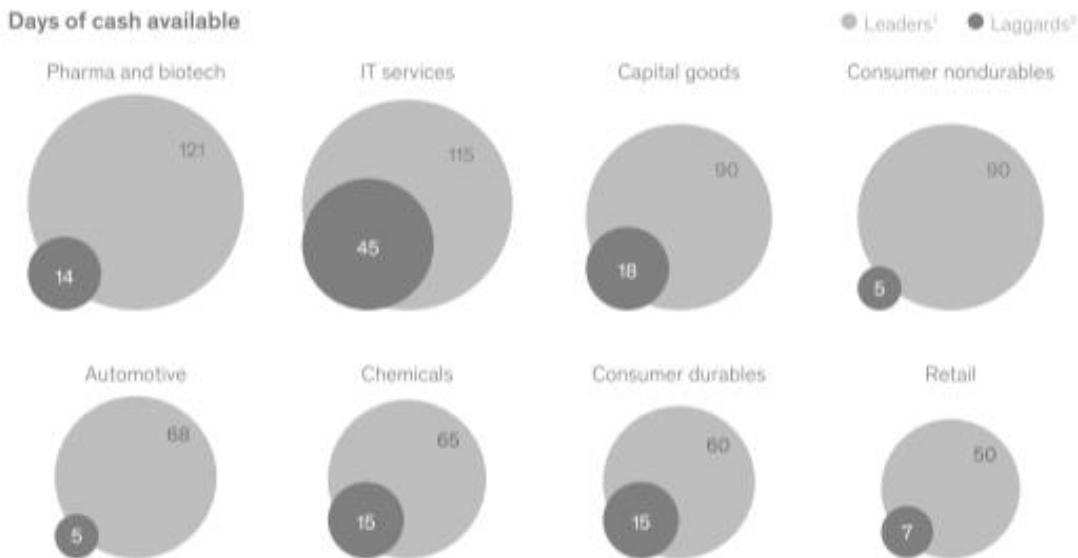
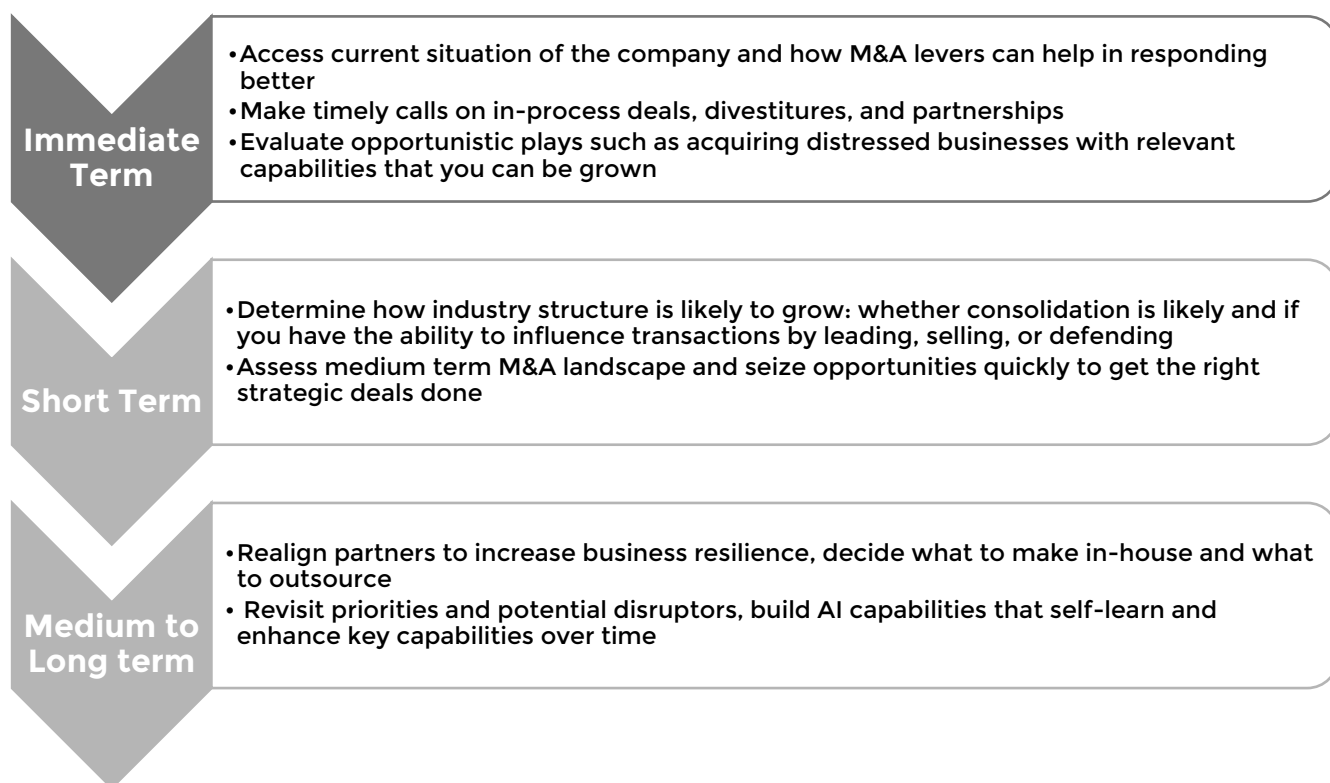


Figure 3: Difference in cash positions between strong and weak firms



Companies have to act quickly. To structure the process, they can make appropriate timelines focusing on the short and medium-term. The following framework can help:



### Strengthening Due Diligence amidst crises

But what about Due diligence, you ask? As pointed earlier, one of the hurdles created by the pandemic includes a lack of personal meetings that adversely impacts due diligence procedures. This can be reduced using tools like

**Earn-outs:** Tying the final purchase price to the future performance of the business

**Indemnities:** Allows the buyer to keep a percentage of the purchase price in an escrow account, which would be released to the seller only when all its claims about the business, (such as the state of its inventory), can be verified in a post-crisis environment

**Creative due diligence:** Video tours and drones can be used to conduct inventory checks, paperwork can be studied in virtual break out rooms, employees can be evaluated over video calls.

Far from being out of action through 2020, companies that act strategically and use M&A during this unprecedented economic earthquake will be the ones most likely to prevail as economic activity rebounds.

- Darpan Jain  
IIM Ahmedabad



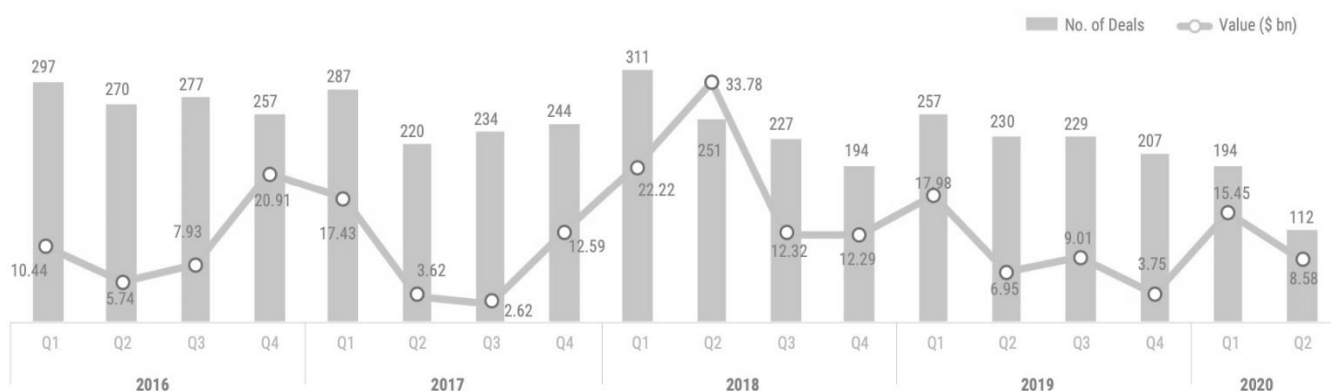
# A MARRIAGE WITH INCREASED TERMS

**THEME BASED SHIFT:** The marriage is for survival and tapping the technology benefit to one's advantage. It is a time to choose your dance players strategically in specific growth areas and definitely with **strong balance sheets**. The deals in which cash flows are better, price volatility is less and balance sheet energy is maintained will likely hold the utmost priority. While overall deal value and volume were down and witnessed **five-year lows**, recent times saw announcements for some of the largest deals of all time in industries ranging from Telecom to Retail. This decrease has been driven by a more protectionist sentiment, lower levels of China outbound M&A activity (down 25% YOY), concerns over Brexit, and more muted market activity. Globally, growing protectionist policies led to companies focusing more on domestic M&A. A rising portion of deals have been in non-core technologies to diversify the revenue mix. Many organisations aimed at transformation of businesses or acquiring new capabilities through setting foot in other industries- notably technology, which remains a top M&A target. Thus, **digital transformation has been an important theme** as pandemic has forced business recasts and new market realities. Also, a prominent trend particularly in India is enterprises acquiring start-ups to acquire competition.





Retail giants, Telecom players and even Pharmaceuticals made strategic investments in technology players. This is surely attributed to the change in landscape towards leveraging AI and Data. This is evident from many examples like the Verizon's deal to acquire video conferencing company Blue Jeans Network, Zywave which recently acquired a private equity firm Clearlake Capital Group which is known to have purchased a software agency Aurora Capital Partners, Livingo and Teledoc merger also reinforces the same idea to provide high-tech solutions and of course, Zoom strengthening its foothold announced its first acquisition of Keybase amidst security concerns. At the same time there are some who are walking away from M&A like Boeing which abandoned its acquisition of Embraer's business. The current & ongoing deals have seen many pauses and full stops as well.



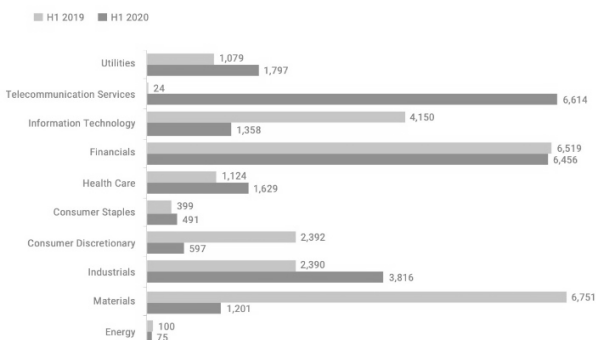
#### APPROACH BASED SHIFT:

A traditional goal-screening approach within a described enterprise boundary is hardly adequate in today's environment. The best acquirers are swiftly growing broader marketplace-sensing capabilities to become aware of and track new technology and new business models. Historically, the most important offers were rooted in scale economics, capturing the cost benefits and patron overlap by becoming a bigger participant in an industry. The fundamental justification for many deals has now shifted to an orientation towards scope - that is, more deals are established on getting into faster growing lines of

business or acquiring new capabilities. Scope deal making has elevated and now represents roughly 60% of all big offers as businesses live prompted to buy into new boom regions and competencies. The industries such as healthcare, technology and consumer products displaying the most powerful momentum have a high scope in M&A deals.

The rising angst among people about economic and political well-being is questioning the role of massive corporations and their influence on day-to-day life. The ensuing political pressure has brought about essential rethinking about antitrust laws and national security mandates in approving deals. Some sectors, such as technology, aerospace and

defense, telecommunications, and healthcare, lend themselves to more scrutiny on non-traditional grounds than others do. Also, the M&A screening is evolving to an outside-in approach from an inside-out approach. This process begins by identifying the sectors of high growth in the broad markets, which involve assessing how earnings pool may shift in the near future and where is the smart cash heading. Then it narrows down to sectors that have a significant tally with the company's existing differentiated capabilities that define its right to win in these novel businesses. Sectors identified using the outside-in approach still need to be material to the existing portfolio of assets.



**CHALLENGES:** In these VUCA times the world economy saw a huge number of M&A activities mainly driven by small sized firms coming together to enhance scale and better position themselves in global marketplace. But another major problem caused by the pandemic is that one cannot perform due diligence when travel is restricted. Also, the geopolitical uncertainty remained a headwind throughout the year, affecting M&A activity. As a result, cross-border activity declined as growing protectionist policies led to companies focusing more on domestic M&A. While macroeconomic and geopolitical uncertainty will likely continue to affect markets, analysts suggest that the strategic dialogue will remain high. In 2020, M&A activity will be depending upon companies looking to strengthen their operations, particularly during periods of prolonged uncertainty. Markets around the globe will keep a watchful eye on the European M&A market, pressuring the region to resurface into the takeover arena to maintain its competitive advantage. Valuations, deal outlays and incentives have to be pressing and convincing to win the bid. The COVID angle might have to be factored into the valuations under some add-backs. Another risk would be the data breach and data security risk due to work from home policies. Thus, there is a requirement of increased diligence.



**COMING DOWN TO INDIA:** Merger and acquisition (M&A) activities in India witnessed a downtrend in the first half of 2020 with total deal value touching a three-year low under the shadow of the pandemic, liquidity crunch in the wake of and the ongoing pre-COVID slowdown. Financials, Telecommunication, and consumer/retail are the predominant sectors for H1 2020, bagging the big-ticket transactions that accounted for 70% of the total deal value. Deal activity in India were mostly dependent on portion buyout deals, distressed opportunities and the continued attractiveness to technology sector. Private Equity influence over the M&A have increased significantly. The deal activities are gradually returning to usual levels in some sectors and regions, and experts are cautiously optimistic.

TechBuzz has come down to India as well. With 30% of all deals in Indian IT services and software market. The deals in EdTech and Fintech were enormous. Also, the start-up world has been buzzing with deals with well performing companies running to acquire competition. Firms have also been leveraging the lower valuations in the short term. Considering Byju's acquisition of WhiteHat Jr or Unacademy's acquisition of Mastree are some examples. FinTech saw continued activity because of the execution of multiple acquisitions. For example Globally, the announcement made by Visa in January 2020 to acquire Plaid for US\$5.3 billion. With the changes in the taste and preferences of the consumers FMCG companies are adapting to the healthy lifestyle themes and innovating products. Kishore Biyani sold the highly leveraged business of Future group to reliance retail.

***Merger and acquisition (M&A) activities in India witnessed a downtrend in the first half of 2020 with total deal value touching a three-year low***



For future group it would help in getting rid of debt as it was hit hard by the pandemic and for RIL, it would be a significant step to become dominant in India's retail sector. Snapping up challengers and acquiring capabilities.

**OUTLOOK:** After a slow first quarter, the deal activity has regained its pace in the second quarter of this financial year. This was primarily due the big numbered deals which were announced by the private equity funds and healthy companies. This momentum of the M&A activity will continue in the near future in some sectors which have played a significant role in this time. These include information technology and ecommerce, and also manufacturing sector which picked up quite well after the pandemic induced lockdown was lifted. An acceleration in consolidation activity can be foreseen, essentially because the market players would want to strengthen their balance sheet figures and build for future growth. Also, despite the weak macroeconomic scenario, M&A activities is expected to show resilience due to attractive tax

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***There has been continued disinvestment of state-owned assets and growing confidence in the insolvency regime which would fuel the M&A activity in India.***

policies, the removal of certain sectoral caps and other reforms. There has been continued disinvestment of state-owned assets and growing confidence in the insolvency regime which would fuel the M&A activity in India.

Whether or not we face a recession over the next couple of years, the most successful companies will take advantage of any opportunity to strengthen their structural positioning in the market through pre-planned M&A and divestiture action.

On the technical front, upgrading the M&A valuation process, pitch books, technical solutions, and all the other resources in all markets is needed to completely support the strategic objectives. M&A are difficult in environment and COVID has made the job tougher.

- Kavvika and Bhavika  
NMIMS Mumbai







The famous founder and CEO of the Ford cars, Mr. Henry Ford said,

***“Coming together is a beginning, keeping together is progress and working together is a success”.***

Merger & Acquisition has brought forth the same concept of beginning & progressing in between companies to fulfill their long-term goals and hence M&A comes with a lot of benefits and advantages in today's world of growing economy and globalization where most of the companies are struggling to achieve the optimal market share possible on both market level i.e. Domestic and International market. M&A is said to have a profound effect on a company's growth prospects and long-term outlook involving a significant amount of risk.

Despite risk these companies look for an organic growth that can take years or decades to double the size of the company, powerful motivation to stay and survive when there is top-notch competitions in global market, take advantage of synergies and economies of scale, dominate their sector and for reduced tax bill purpose. Even after being benefited, there are few reasons due to which M&A fails at certain level and that are Integration risk,



# M&A

## MANAGING CULTURE





overpayment and culture clash and various other internal reasons. Considering culture as one of a drawback in M&A, it gives us a point to introspect and find where and how it could be a reason for M&A to flourish in upcoming years i.e. what more could M&A do in terms of culture?

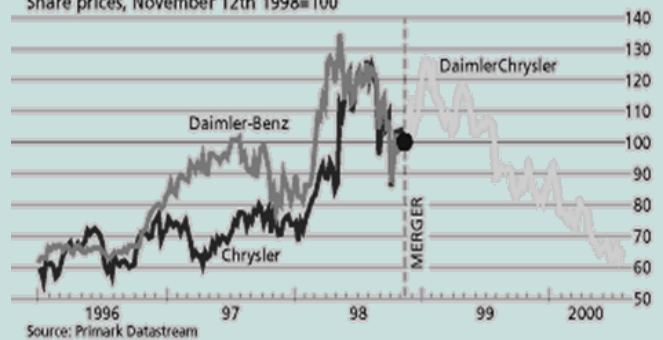
According to Oxford Dictionary the definition of culture is the customs and beliefs, art, way of life, and social organization of a particular country or group. It could also be defined as

*“a culture consists of the long standing, largely implicit shared values, beliefs, and assumptions that influence behavior, attitudes, and meaning in a company (or society)”.*

Both the definitions clearly portray few implications that culture is implicit and resilient. It influences how people behave and how people understand their own actions. Culture varies from one country to another, from one business to another, from one home to another and when there is any kind of merging and acquisition between these cultures can definitely bring challenges to cope up with. For example, Daimler and Chrysler (the makers of Mercedes-Benz) merged with American company Chrysler in the late 1990s, it was called a “merger of equals”. A few years later it was being termed as a “fiasco”. As soon as they merged, discordant company cultures had the two divisions at war. Differences between the companies included their level of formality, philosophy on issues such as pay and expenses, and operating styles. The German culture became dominant and employee satisfaction levels at Chrysler dropped off the map. Major losses were projected by 2000, and a year later, layoffs began.

### The value of a deal

Share prices, November 12th 1998=100



The graph shows the huge decrement of the value of the deal after merging and apparently in 2007 not being able to hold more losses, Daimler sold Chrysler to Cerberus Capital Management for \$6 billion. The merging in between the similar and profitable sector led to huge losses due to cultural clash that could not be sorted out and in the end, it had to be sold to some other company. Hence, culture has emerged as one of the dominant barriers to effective integrations. In one study, culture was found to be the cause of 30 percent of failed integrations. Companies with different cultures find it difficult, if not often impossible, to make decisions quickly and correctly or to operate effectively and successfully.

Now the question is how the other companies have been performing well in existence with the cultural differences and what could the failing companies do to achieve M&A benefits by eliminating the cultural clash? The answer to both the questions is that these organizations or companies must identify the key areas to avoid when it comes to M&A and follow certain guidelines for creating a successful merger.



1

What could be avoided is the loss of key people. When acquiring an organization, the downside if not handled rightly can lead to loss of key people and the venture can be jeopardized. One of the surveys mentioned in Merger and Acquisition Magazine, indicated that only 42% of the managers remained with the acquired company for as long as five years.

2

Immediately after M&A, people almost start to focus on the differences in the companies which they should not do. They also quickly begin to “keep score” on who are the winners and losers. It is typical in an acquisition for the acquiring company to see themselves as the winners and the other as the losers and the winners typically impose changes and views those in the acquired company as highly resistant to change.

3

Rather than respecting and building on differences, people frequently enter right and wrong judgements. They must be steer clear away from being judgmental about the way things are handled by the other.

4

Whether a merger is for the better or worse, it throws relationships, norms, work behavior and support systems out of balance causing chronic problems in attitude and behavior. Harry Levinson, a management psychologist and Harvard professor emeritus states that even when a merger offers new opportunities, it still tends to be perceived as a threat one's equilibrium. One must stay away from such fear of the unknown because insecurity is the enemy.

5

All of the above discussed points lead to loss of organizational effectiveness causing employees to lose enthusiasm about their work and their organization resulting in suffering within company and customers are lost.

After looking at what could be avoided, few things that an organization can follow is to retain key leaders critical to continued success and initiate a plan to ensure that they stay and remain engaged and aligned. Communicate the new vision soon so that the people can settle down and refocus their energy in a forward direction. Address the new organizational structure as early as possible.





Be clear about the nature of the union and be willing to talk about it. Communicate the benefits of the merger as it will provide a legitimate purpose of the merger. The acquiring company's leader(s) should communicate in person. Successful mergers only happen when senior manager make themselves visible and accessible to all employees affected by the merger and promote the benefits at all levels. Create an integration plan that will systematically connect two cultures and the organization.

Now there are variations in the nature of M&A. There are specific steps needed to deal with the human side of the M&A that are greatly influenced by the basis for the merger as well as the cultures of the organizations. For an organization to have a favorable outcome through M&A requires attention to the management of culture and detailed planning is most crucial. The varying goals for merger outcomes are explained below in their three most common forms.

### 1. Autonomy or semi-autonomy

Here the goal is to create mutual support and synergy without necessarily changing the nature of the organizations. The acquiring company might want some modifications. For example, there may be a desire to shift one or more qualities, such as innovation, bias for action and a higher level of expectations. However, when the basis of acquisition is autonomy or semi-autonomy, respecting the New reasons for the differences in culture and to proceed slowly with integration activities is important.

### 2. Absorb and assimilate

If the organizations goal is to absorb and assimilate completely with the acquired company, then they must primarily educate the acquired employees in the rules of the new game. They have been playing a different game under a different set of unwritten as well as written ground rules. They must be given orientation to the new organization that should include letting them know about vision and values of their organization. It is important for them to know that they have a new set of game to play and focus on the new game rather than judging the past and telling them why and what they were doing was wrong.

### 3. Co-create a new entity

This involves successful cultural integration that involves integration of teams and culture shaping that embeds the new values and shapes the culture through values and guiding behavior. Additionally, it inspires and aligns people around vision, mission, and shared values and follows a pattern of emotional cycle of change.

Hence, it can be said that culture clash though one of the major barriers can be eliminated if we understand and study the actual reason and purpose of M&A, avoiding few practices and following certain guidelines and understand the type of variations the organization needs and how to accepts and implements it. This is how the companies can eliminate the culture issues and can fully take advantages and benefits of M&A by managing it correctly.

- Arpana Deep  
SIIB

# ACTIVITIES CONDUCTED DURING THE YEAR

**Webinar on IBC:** The Objective of the program was to create awareness about industrial sickness, indicators of sickness, factors affecting sickness, understand the main features of the Insolvency and Bankruptcy Code, 2016, CIRP - Corporate Insolvency Resolution Process, and the "BIC 12" under Resolution. Dr Rajesh Ojha, a finance coach who previously was the Senior General Manager- Finance & Accounts at Reliance Jio Info Comm. Ltd. was the speaker for the event. He has a Doctorate in Insolvency & Bankruptcy and is also the Member of INSOL India & INSOL International.

**Market Impact Report:** COVID Impact: This year Team Samriddhi aims to release a new set of reports, Market Impact Reports (MIRs), in which we analyze the recent performance of financial markets. Team Samriddhi proudly presented its first report in this series, Market Update & COVID Impact - June 2020. The report focuses on the effect COVID has had on various asset classes and financial markets globally. We also compare the policy actions taken by various countries vis-a-vis India, in response to the pandemic.

**Atticus Industrial Training Workshop:** Finomenon, in association with Atticus Advisors LLP organized an Industrial Training Workshop which covered Equity research and Financial Modelling. Additionally, Atticus Advisors LLP offered a corporate project to the students who enrolled for the course to give them a more detailed understanding of the concepts covered at the workshop. Students received an opportunity to gain hands-on experience, quality exposure and mentorship throughout the workshop and corporate project.

**The CFA Institute Research Challenge:** It is an annual global competition conducted by the CFAI that provides university students with hands-on mentoring and intensive training in financial analysis and professional ethics. Each team is tested on their analytical, valuation, report writing and presentation skills. They gain real-world experience by assuming the role of a research analyst.

**B-Talks:** B-Talks (Business Talks) is an initiative taken exclusively for Finomenon junior members to help them prepare for the Summer Placements. The Junior Members of Finomenon were allocated companies from Nifty 100 and were asked to analyse and present their research. It comprised of macroeconomic impacts, company strategies, financial comparison and enterprise opportunities and risk which gave the students a comprehensive idea about multiple sectors.

**Decoding Finance:** Decoding Finance is an interactive session for the 1st year students where all their queries are solved, anxieties are addressed and myths are debunked by experienced Finance professionals. This year we had Mr Harshit Shah (CA, LLB, B. Com) and Mr Ronak Gala (MBA, B. Com,) co-founders of 'Leap Up' to guide the students and give them a direction.

**Guest Session on Financial Investment Industry:** The New Norm by CFA Institute: Finomenon, in association with CFA Institute, hosted Mr. Vidhu Shekhar, country head of CFA Institute in India. He is a seasoned financial and investment professional with over 30 years of industry experience in India and abroad.

The theme for the session was "Financial Investment Industry - The New Norm by CFA Institute." He gave the students an overview of the Finance Industry, roles available in the investment management industry, skills and competencies required to thrive in this industry and a brief Introduction to the CFA program.



**Pick of the week:** A weekly competition is organized on the Instagram page of Finomenon whereby clues are given for a stock's performance and the viewers have to make a guess. Hints like weekly gain, 52 weeks high, 52 weeks low or dividend yield are provided. First three correct answers get a mention on the Cell's Instagram page.

**FinSights:** FinSights are weekly news-shorts updated on the social media platforms of Finomenon. Topics such as 'Gold to the rescue', 'Private Equity and technology', 'Rail Privatization', 'Where is the Rupee headed?', 'The Fiscal Conundrum', 'Banker bumble or Deal Tinder', 'The Indian Cloud Battle', 'Jio 5G Bharke?', 'Tik Tok and its valuation', 'Launch of Stock Trading by Paytm', 'Is Flipkart IPO ready?', 'IPLS - The fame of the game?', 'The life ahead for the LIC' 'The buyback saga of TCS' and many more are covered every week.

**Guest Session on Impact of Covid-19 on Debt and Equity markets:** Finomenon organized a session to discuss the volatility and the recent events in debt and equity markets due to the impact of Covid-19. Mr Amit Joshi, Chief Investment Officer of Bajaj Allianz General Insurance was the speaker for the event.

**Article of the month:** In the article of the month for August, we explained what bad banks are, their advantages, the challenges that they face and their relevance in India. For the month of September, we shared an article on Weather Derivatives explaining the meaning of derivatives, uses of derivatives and then providing a glimpse of what weather derivatives are, its evolution and their significance in the Indian market. It was sent to the whole batch to apprise them about the current topics.

**Summerthan:** To help with Summer placements, Finomenon shared Finance dossier with the batch of 2020-22 comprising of all fundamentals of finance. We also shared Summerthan articles, which are based on current events around the globe. The topics covered this year were, "Aviation Industry Covid-19 Impact Analysis and possible strategies to overcome it" and "Future of online grocery and pharma retailing in India" to name a few.

**Samriddhi Equity Research Reports:** Through SERRs, Team Samriddhi extensively covers 'focus' companies in each notable sector of the economy. These reports are in the mould of industry-standard Equity Research Reports, designed primarily to enhance learning. The Team presented its first SERR for the year in the month of June on Asian Paints Limited. The report focused on various stock centers around various demand and growth drivers across segments, the ability to handle competitive pressure and the various government initiatives. The report also covered recent trends in the sector and the impact of COVID-19 on the paints sector.

**Bean Counters:** Finomenon organized a fun-filled event 'Bean Counters' for the 1st year students having multiple rounds including a quiz, treasure hunt and monopoly. Students were able to gain insights into the financial world as all the rounds involved questions revolving around the financial concepts. They were also asked financial questions based on different sectors in monopoly which was the final round of the event.

**Samriddhi Intelligence Report:** Team Samriddhi, in the month of October, presented its latest report for the Samriddhi investors. Through the SIR, we delved deeper into the FMCG Sector focusing on certain themes such as growth leverage, COVID impact, segment wise analysis and recent important M&A transactions as well as analysis of the impact of retail consolidation on the sector. The report also covered market performance summary and study of key players in the industry including Britannia Ltd, Hindustan Unilever Ltd, ITC Ltd etc.

# MEET THE TEAM

## THE SENIOR TEAM: KEEPING UP WITH THE NEW NORMAL



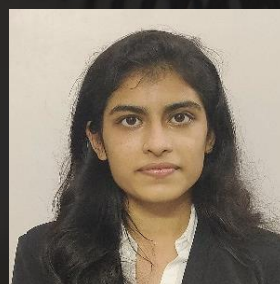
## THE JUNIOR TEAM



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