Basic concepts of merger and acquisitions finance essay

Finance

CHAPTER 1IntroductionMergers and Acquisition has been a very popular vehicle for growth and restructuring in the corporate world during the last couple of decades. The economic liberalization and globalization have brought Merger & Acquisition to the forefront in the new economic paradigm. Liberalization has given birth to competition and globalization to search worldwide competitive advantage. In the process industries have eyed Merger & Acquisition for the twin objective of growth to face the competition and means to acquire market growth. Growth by internal expansion occurs when a company adopts new construction of plant and installations of new and additional machinery to add to the already available infrastructures. However growth by mergers, takeovers, spin-offs, divestitures etc. are also an important route for growth which is also known as corporate restructuring. Merger and acquisitions, restructuring, corporate control activities represent new industrial tool which has become the central point of discussions as well as public and corporate policy issues in the newspapers recently. Since Merger and Acquisition is an efficient method of corporate restructuring, it has become an integral part of long term business strategy of corporate enterprises. Further the recent industrial recession and economic meltdown faced by the world wide economies has necessitated the eagerness of corporate houses and economists to look into the alternate route of merger and acquisition for growth, expansion, economic restructuring and business overhaul in order to be competitive and making their felt in the market. Hence of late merger and acquisition has occupied a prominent position in the economy and corporate world. BASIC CONCEPTS OF MERGER AND ACQUISITIONSMeaning of Mergers and acquisitions: The phrase " Mergers and Acquisitions" specifically refers to " corporate strategy, corporate finance & corporate management dealing with buying, selling and combining of different firms which can provide help, resources, money or aid a growing firm in a given industry to grow rapidly without having the need to create another business entity". According to Chung and Hoag (2000) " any transaction that forms one economic unit out of two or more previous economic units is called merger. Merger is defined as the combination of two or more firms or corporations, units, industries etc. where only one survive and other(s) (merged) goes out of existence leaving the merged one". Merger and acquisitions indicates situations where independently owned firms join together under the same ownership (Shy, 1995). Hence Merger and Acquisitions is combination of two firms which refer to the purchase or sale of a company in full or in part. According to Machiraju (2003) Merger is a very broad term. Merger denotes the combination of two or more forms or companies in a way that only one survives and the other(s) is/are dissolved. A merger can be an investment in a future growth opportunity. When two companies generally differ significantly in their size, they usually merge to make a bigger one. Acquisition refers to a situation where one firm acquires one/more other forms where the later one or more ceases to exist. Acquisition occurs when one company takes controlling interest in another firm or its legal subsidiary or selected assets of another firm. Merger is popularly understood to be a fusion of two companies where as acquisition generally denotes a company acquiring controlling the stake in another company in such a way that that the acquirer company can have the management control over the acquired firm (Kar, 2006). Hence in Merger two or more companies get fused to one. Acquisition is Purchase of a substantial part of assets or securities by one company of another, normally for the main purpose of restructuring the operations of the acquired entity. This can otherwise be known as take over. Other three terms associated with merger and acquisitions are amalgamation, take over and leveraged buyouts Machiraju (2003). Amalgamation is the process of blending of two or more companies into one. The shareholders of each blending company becoming substantially the shareholders of other company (acquirer) which holds the blended company. In an amalgamation the assets and liabilities of the two companies are vested in one which has as its share holders all or substantially all the share holders of the two companies. In takeover, shares may be purchased from the market to acquire a controlling interest and the target company may be maintained as a subsidiary or division or dissolved to merge. In a takeover a seller’s management may oppose the merger or acquisition, but the buyer makes a direct bid to the sellers shareholders to acquire sellers shares and thus gain control of the sellers company. Hence take over may be friendly or unfriendly. The acquirer bypasses the management by going directly to the target shareholders. 1. 2. 2. Types of mergers and acquisitions: There are five major types of merger and acquisitions, like horizontal, vertical, market extension, conglomerate and consolidation (Chung and Hoag (2000). Horizontal merger: It is the merger that takes place between two or more firms/companies which operate & compete in the same business activity and also in the same geographical area. It indicates the two companies are direct competitors prior to their merger in the same industry. Vertical merger: Such kind of merger occurs between firms in different stages of production operation like operations of a supplier and a customer. It may be backward vertical merger or forward vertical merger. Market extension merger: It is the merger between two companies in similar fields of sales without overlapping but may expand the acquiring firm's geographical reach to the product market. Conglomerate mergers: It involve when firms engaged in unrelated or different types of business activities i. e. different lines of business, merge under the same ownership indicating that they have no evident relationship before the merger. Consolidation merger: This kind of merger takes place between two or more firms who are engaged in similar or same type of business under the control of the same management.

SCOPE AND IMPORTANCE OF MERGERS AND ACQUISITIONS:

The business activity is becoming more and more complex, risky and unpredictable day by day. The ever changing socio economic pattern of business and cultural and demographic changes of society has necessitated the need to relook into the business activity. The aim to grow in the business has focused the attention on different strategies for the same. Organic growth through green field expansion, by up-scaling capabilities and establishing new firms with fresh investment is the real growth for the country or society. This is called internal growth where setting up own units and new products for the market is done. However due to multiple problems involved in the internal growth process, firms undertake external growth by way of mergers, acquisitions, takeovers joint ventures etc. This is a focus on short cut methods of expansions and growth through mergers and acquisitions. The external growth has many advantages like save in time, energy and resources in starting a new business. Hence popularity of mergers and acquisitions in the corporate world and economic environment has multiplied in recent times. Leveraged buyout (LBO) is the purchase of a company financed primarily by debt. LBOs permit entrepreneurs who are perceived as skilful managers to acquire valuable assets for a relatively minimal amount of equity capital. Banks, insurers, and other financing institutions finance LBO if the business has valuable assets for a relatively minimal amount of equity capital. Acquiring Company is a firm which attempts to acquire or merge with another firm or company. The firm which is being solicited/ acquired by the acquiring company is called the target company. It is the target company which is sought for by the acquiring company. Mergers and Acquisitions continue to grow at an increasing pace during the last couple of decades. In today’s competitive business environment, successful business management depends on the proper understanding of the complexities and consequences of the merger and acquisition involved in it. The growth in this Merger & Acquisition field has excited the stake holders and researchers to have an inquisitive and intensive look into it. Due to the spurt in the activities of mergers and acquisitions there is need to find out the successfulness of such activities and hence the researchers have put additional efforts to find out the impact of mergers and acquisitions in the performance of the corporate.

HISTORICAL OVERVIEWS:

Mergers and acquisitions in USA and merger waves:

In USA mergers and acquisitions are wide spread and are numerously filled in the economic dailies. Large scale mega mergers and hostile deals are very common in USA economy. The history of mergers in USA has different periods of merger and acquisition. Five periods of high merger activity, called as waves have taken place in the history of United States (Gaughan, 2007). These waves have been characteristically been cyclic activity with high levels of mergers followed by periods of relatively fewer deals. The five waves can be marked during different periods likeFirst wave: 1897- 1904, Second wave: 1916- 1929, Third wave: 1965- 1969, Fourth wave: 1984- 1989, andFifth wave: 1992- 2005. The five merger waves transformed the USA economy from small and medium sized business base to a more complicated form of multinational corporations. Each merger wave is the outcome of different reasons and they have produced different results. It is quite visible that worldwide there is noticeable increase in corporate mergers and acquisitions in terms of number of announcements and value. As per figure 1. 1 there is drastic increase in mergers and acquisitions in the world between 1985- 2012 in terms of numbers and dollar value. Between 2000- 2002 there is decline in mergers due to economy slow down. Also in recent times between 2007- 2011, there is slow activity due to world wide economic recession. Figure 1. 1: Trend in worldwide mergers and acquisitionshttp://www. imaa-institute. org/images/figure_announced %20mergers%20&%20acquisitions%20(worldwide). jpgSource: MERGERSTAT Review, 1985 and 2012Value wise also merger and acquisition is very important in the world economic scenario. Below the top ten merger deals in the world is given which implies the economic value, importance and cross country spread of the deals.

Top 10 Worldwide M&As by Value of Transaction

Date

Announced

Date

Effective

Value of

Transaction

($mil)

Target Name

Target

Nation

Acquirer Name

Acquirer

Nation

11/14/19996/19/2000202, 785. 13Mannesmann AGGermanyVodafone AirTouch PLCUK1/10/20001/12/2001164, 746. 86Time WarnerUSAAmerica Online IncUSA8/29/20073/28/2008107, 649. 95Philip Morris Intl IncSwitzerlandShareholdersSwitzerland4/25/200711/2/200798, 189. 19ABN-AMRO Holding NVNetherlandsRFS Holdings BVNetherlands11/4/19996/19/200089, 167. 72Warner-Lambert CoUSAPfizer

IncUSA12/1/199811/30/199978, 945. 79Mobil CorpUSAExxon CorpUSA1/17/200012/27/200075, 960. 85SmithKline Beecham PLCUKGlaxo Wellcome PLCUK10/28/20048/9/200574, 558. 58Shell Transport & Trading CoUKRoyal Dutch Petroleum CoNetherlands3/5/200612/29/200672, 671. 00BellSouth CorpUSAAT&T IncUSA4/6/199810/8/199872, 558. 18CiticorpUSATravelers Group IncUSA

Table 1. 1 Top 10 Worldwide M&As by Value of Transaction

Source: Thompson Financial, 4/9/2008

Updated: 4/14/2008

Mergers and acquisitions in India:

Large number of merger and acquisitions occurred in India in jute, sugar, cotton, textile, banking, tea plantation etc. which were predominately in the early post independent ear. However the anti big industry policies of Govt. of India of 1960s and 1970s deterred the wide scale mergers and acquisitions. The Industries Development and Regulation act 1951, Import control order, 1957, Monopolies & Restrictive Trade Practices Act’1969, Foreign Exchange Regulation Act’1973 are prominent anti Merger regulations enacted by Govt. of India. After the economic liberalization of 1991 and adoption of Globalization as a policy, Mergers and Acquisitions are catching up in India. Companies in the post liberization period identified their core competencies and tried to consolidate on the same. Further they identified the areas where they do not have competitive advantage. These two aspects led to the corporate restructuring by way of wide scale Mergers and Acquisitions. The recent upsurge in Mergers and Acquisitions has been possible due to the changes brought out by the Industrial Policy Resolution of June' 1991. (Khanna, 1998; Basant, 2000). The MRTP Act and FERA have been amended paving the way for large business houses and foreign companies to adopt Mergers & Acquisitions for further growth. The current merger wave in India can be termed as the first merger wave triggered by market reforms (Bhoi, 2000: Lakshminarayanan, 2005). The policy of delicensing, de-reservation, relaxation under MRTP, liberal FDI inflows and unrestricted import of new technology and knowledge, Mergers and Acquisitions are being taken up by our Indian corporates extensively. In India the merger wave have started late in mid 1990s only after the economic liberalization and globalization of economy. In the last two decades the Mergers have gone up considerably. This is because there have been changes in various spheres like technology, transportation, communication, market development, accelerated competition, emergence of new competition, very congenial economic and financial environment and relaxation of various inhibiting factors. The merger value starting from 1994 has gone up gradually and considerably. Figure I give a graphical representation of merger value in India during the period 1994-2005. Figure 1. 2 : Trend in Mergers and acquisition in IndiaSource: Thomson Securities Financial Data / www. wiley. Com / go / mergers

MERGER AND ACQUISITIONS IN METAL AND METALIC INDUSTRIES IN INDIA:

According to Kar (2006), the Indian manufacturing industries have been classified broadly into seven categories of industries like a) Food beverages, b) Textiles, c) Chemicals, drugs and pharmaceuticals, d) Non- metallic mineral products , e) Metals and metallic products, f) machinery products, and g) miscellaneous manufacturing and diversified products. In India during the period 1991- 2007, there have been around 3466 mergers out of which maximum being in Chemicals, Drugs and Pharmaceuticals sectors. (CMIE Prowess data base). Not much activity has taken place in metals and metallic products sector during this period.

Importance of metals and metallic industries:

Metal has taken an important role in the development of human civilization. The evolution of man through the ancient age, then Stone Age and later passed on through Iron Age. It is metal which has given a new direction and dimension to the development of human civilization. Since the Iron Age metals like Iron and Later bronze and much later other metals like silver and gold etc had been associated with man directly in various day to day activities. India with vast natural resources is richly endowed with mineral deposits like iron ore, copper, bauxite, gold, chromites, manganese etc. India’s march in the post independent era from agrarian society to an industrial society has been basically based on growth of metal and metallic industries. Metal and metallic industries are the indispensable part of any kind of economy. These industries form the back bone of industrial development of any country. The industrial growth & development in our country started with setting up of TISCO (Tata Iron and Steel Company) at Jamshedpur in 1907. Then set up were Burnpur steel plant and Bhadrawati Steel Plant in 1919 and 1923 respectively. In the post Independent era, SAIL was set under Public Sector with steel plants at Rourkella, Bhillai and Bokaro near the sources of raw material and access to efficient transportation network. Besides Iron and steel industries, there were gradual developments of heavy engineering and machine tools industries also. The steel based ancillary industries and downstream industries also developed in India. The HEC, Ranchi; TELCO, Jamshedpur; HMT, Bangalore; BHEL, Bhopal etc are shining examples of Indian metal industries. Aluminum industries are one of the important industries in Indian economy. India has huge deposits of Bauxite. Hence Aluminium industry in India has flourished well and has taken an important position in the Industrial development of the country. The important companies under aluminium in India are HINDALCO, INDAL, NALCO, BALCO, MALCO etc. Aluminum based industries like air craft manufacturing, auto mobile manufacturing etc has grown up considerably. In addition to Iron, Steel, Aluminium; other metal industries based on metals like Copper, Zinc, Ferro Alloys, Manganese, Lead, Gold, Silver etc have developed significantly in India. India is one of the leading producers of minerals and out of 89 minerals produced in India, 11 are metals which account for 3. 5% of GDP and 10% share in the index of industrial production. (www. indianmetals. com/ news/mineral and mining)India is the second most populous country in the world. It is also an important country for the metal industry employing almost three million workers in this sector. It is believed that the mineral wealth of India was indeed a source of attraction for the British who conquered India and conducted several Geological surveys in their early presence in this country. All the above give an indication regarding the importance of metal and metallic industries in the economy of India. Hence it is worth to study different activities in the metal and metallic sectors and more particularly the mergers and acquisitions due to its increased importance in economy, employment, development etc.

Merger activities in steel industries in India:

The importance of steel has not been felt till the recent past when steel prices were ruling high in international market and also in Indian market. The cause of high inflation in Indian Economy was partially attributed to the high steel prices ruling in India then. Needless to say that it has been observed that the consumption of steel is directly proportional to the GDP growth of any economy (www. steelguru. com). The importance of steel compelled the Government of India to announce the National Steel Policy, which itself indicates the importance of steel in Indian economy. In Japan, Europe, Canada and USA merger and acquisition in steel industries and allied industries have occupied the central stage. Global players in the field have invaded these countries to play an active role in iron and steel and minerals industries sector. After Japan, USA and Europe it is the turn of India and China who are the next battle ground of global steel battle. China with its increased per capita consumption and India with its vast iron ore deposits and potential for vast production and consumption have occupied the central stage in world steel map. Global Steel giants have come to explore and capture the steel sector in India. Consolidation has become the thumb rule of steel business in the recent years. The major Merger and Acquisition deals in International steel sector are given in the table below. Table-1: MAJOR MERGER & ACQUISITION IN INTERNATIONAL STEEL: Sl. No

Acquirer

Acquired

Value ($ b USD)

1Mittal steelArcellor382Tata SteelCorus Group123U S SteelLone Star Technologies2. 14SSAB Svenskit Staal A B (Switzerland)IPSCO (US)7. 75Nucor (US)Harris Steel2. 046Essar GlobalAlgoma Steel Inc1. 63(Source: www. steelguru. com)Next to Steel and Iron, it is the aluminum industry where merger and acquisitions have taken place extensively. Traditionally aluminum sector has experienced much less Merger activity than the steel sector. With presence of many big aluminum industries in India like BALCO, NALCO etc. the importance of this sector in merger and in economy cannot be overlooked. The other metal sector excepting Steel and aluminum, have experienced a somewhat smaller surge in activity. There have been occasional activities in mergers in case of other non ferrous metallic and manufacturing industries like Aluminum, Zinc and Coppers etc. in India. Major Mergers and Acquisition in non ferrous industries has also been taken place during the last decade.

Significance of the study:

There has been considerable diversity in the findings of effects of Merger and Acquisition in the world. Some have opinioned that Mergers are advantageous and some others have given quite opposite opinion with a few advocating neither beneficial nor harmful effect. In the world, the Mergers and Acquisitions were mainly concentrated at financial sectors and Pharmaceuticals sectors. In India also there have been focuses on Bank Mergers and Acquisitions with rare activities in other industries. Not enough research on Mergers and Acquisitions has been made in India till date. Further no study on impact of Mergers and Acquisitions on financial performance on merging firms in Metals and Metallic products sector have been made exclusively in India till date. An attempt is being made through this study to analyze the impact of Merger and Acquisition on Metals and Metallic product sector in India. For this all major Mergers and Acquisitions post liberalization i. e. since 1994 till 2008, whose financial data is available, have been proposed to be considered and studied empirically. The present research work is the outcome of an interest to study the impact of Mergers and Acquisitions in steel and other metallic sectors which has been prompted by the two mega mergers in the global steel sector like a) Arcellor Mittals and b) Tata Chorus deals. Further there is occasional spurt in the media, discussion in public and ministry of steel, Govt. of India, regarding merger of Government controlled steel sectors in India like SAIL, RINL, NINL, NMDC, MOIL etc. The present attempt is aimed at studying and comparing the financial performance of the firms in pre-merger and post merger era to find out whether merger has brought improved performance to the acquirer firms in the post merger period as compared to the premerger period or it has deteriorated. In this research, event study method is proposed to be adopted to investigate post merger financial performance taking stock market data in metal and metallic sectors in India. Further accounting based measures also studied to investigate long term impact of M & A on the acquiring firms in metal and metallic sector. Both event study and accounting based studies will give a better result on short term and long term impact of M & A on financial performance of metal and metallic sectors in India. The effort may also help the potential merging and acquiring firms in their decision making.

ORGANIZATION OF THIS RESEARCH

The presentation of this research work is organized in five parts each consisting of one to more than one chapters totaling 10 chapters. A brief outline of different parts is given as follows: Part 1 and Chapter 1 deals with the introduction of the study, basic concepts of merger and acquisition, importance and scope of merger and acquisition, merger and acquisitions in USA and India, merger and acquisitions in metal and metallic industries in Indian and organization of this research. Part 2 contains 2 chapters, Chapter 2 and Chapter 3. These two chapters review the literature relevant to this research. Literature review covers study of post merger financial performance, Event study and Accounting study, importance of accounting study, Accounting study in other countries like USA, Canada, Europe, Australia and Asian countries, study conducted in India.. In the literature review section also methods used for conducting studies has been discussed. A summary of the literature review is given at the end for easy comprehension and comparison. Part 3 and Chapter 4 presents the methodology of the study which covers Type of Research, Data and its Sources, Sampling procedure, Data characteristics, Data collection instrument, Analysis Technique, and Hypothesis to be tested. Part 4 contains 3 chapters which covers Data analysis and empirical findings. Different findings along with the data analysis have been arranged in five chapters. In this section the findings of the study related to the impact of mergers and acquisitions on financial performance has been described in detail. It covers the data sheet through which different data were collected analysis of the data, different tables and graphs and interpretation of the analysis. In Part 5, Chapter 5 major findings and significant contributions of the research are summarized followed by a set of recommendations. The thesis finally ends with limitations of the study and suggestions for the further research. At the end the References is attached which is followed by Appendices which contains Sampling Plan, List of Bidding firms, List of Target firms, Data collection forms, a brief description of different financial ratios and Supporting Tables etc through Appendix A- G.

1. 7CONCLUSION:

The introduction chapter presents an overview of context related to the research work. The basic concepts of merger and importance of mergers and acquisition including the mergers in USA and India has been described. Further importance of metals and metallic industries in Indian economy along with the merger and acquisitions in metal sector in India has been given. In the subsequent section the interesting findings of different studies conducted elsewhere in the field of mergers and acquisitions in different sectors would be described as literature review.