Business is a Game…….

Did you read Tomorrow's Newspaper

- *Walmart to be merged into Pantaloon*
- *Infosys to acquire Microsoft*
- *NDTV bids for hostile takeover of BBC*
- *LBO of General Motors by Tata Motors*

Modes of growth

- Basically, there can be three ways it:
  - The formation of a new company;
  - The acquisition of an existing company;
  - Merger with an existing company.
- Decision ---company’s assessment of various factors including in particular:
  - The cost that it is prepared to incur;
  - The likelihood of success that is expected;
  - The degree of managerial control that it requires to retain.

Corporate Restructuring

Expansion

- Amalgamation
- Absorption
- Tender Offer
- Asset Acquisition

Contraction

- Spin off
- -Split ups
- -Asset Sales
- Equity carve
- outs

Controls

- Going Private
- -Eq. Buy Back
- -Anti-Takeover Defense
- Leveraged Buyouts

Merger

- Merger is a fusion between two or more enterprises, whereby the identity of one or more is lost and the result is a single enterprise.
- Merger is restricted to a case where the assets and liabilities of the companies get vested in another company, the company which is merged losing its identity and its shareholders becoming shareholders of the other company.

Merger (Cont’d)

- Two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated.
- Stock of both the companies are surrendered and new company stock is issued in its place.
- Daimler-Benz andChrysler to
  - DaimlerChrysler

Merger (Cont'd)

- When two or more companies consolidate by exchanging common stock, and the resulting single company replaces the old companies, the consolidation is described as a ***merger*.**
- The shareholders of the old companies receive prorated shares in the new company.
- A merger is typically a tax-free transaction, meaning that shareholders owe no capital gains or lost taxes on the stock that is being exchanged

Acquisition

- An acquisition, also known as a takeover, is the buying of one company (the ‘target’) by another.
- In acquisition, one company purchases, or takes over, the assets of another.
- The acquiring company continues to function and the acquired company ceases to exist.
- Shareholders of the acquired company receive shares in the new company in exchange for their old shares.

Acquisition (Cont'd)

The term acquisition has not been defined under the Companies Act. However, the term acquirer and control has been defined under the Takeover Code.

Takeover is a business strategy of acquiring control over the management of the target company, either directly or indirectly

The motive of the acquirer is to gain control over the board of directors of the target company for synergy in decision making

Acquisition (Cont'd)

- When one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition.
- From a legal point of view, the buyer "swallows" the business of the target and the buyer's stock continues to be traded

Acquisition (Cont’d)

- A corporate action in which a company buys most, if not all, of the target company's ownership stakes in order to assume control of the target firm.
- Acquisitions are often made as part of a company's growth strategy whereby it is more beneficial to take over an existing firm's operations and niche compared to expanding on its own.
- Acquisitions are often paid in cash, the acquiring company's stock or a combination of both.
- An acquisition may be friendly or hostile.

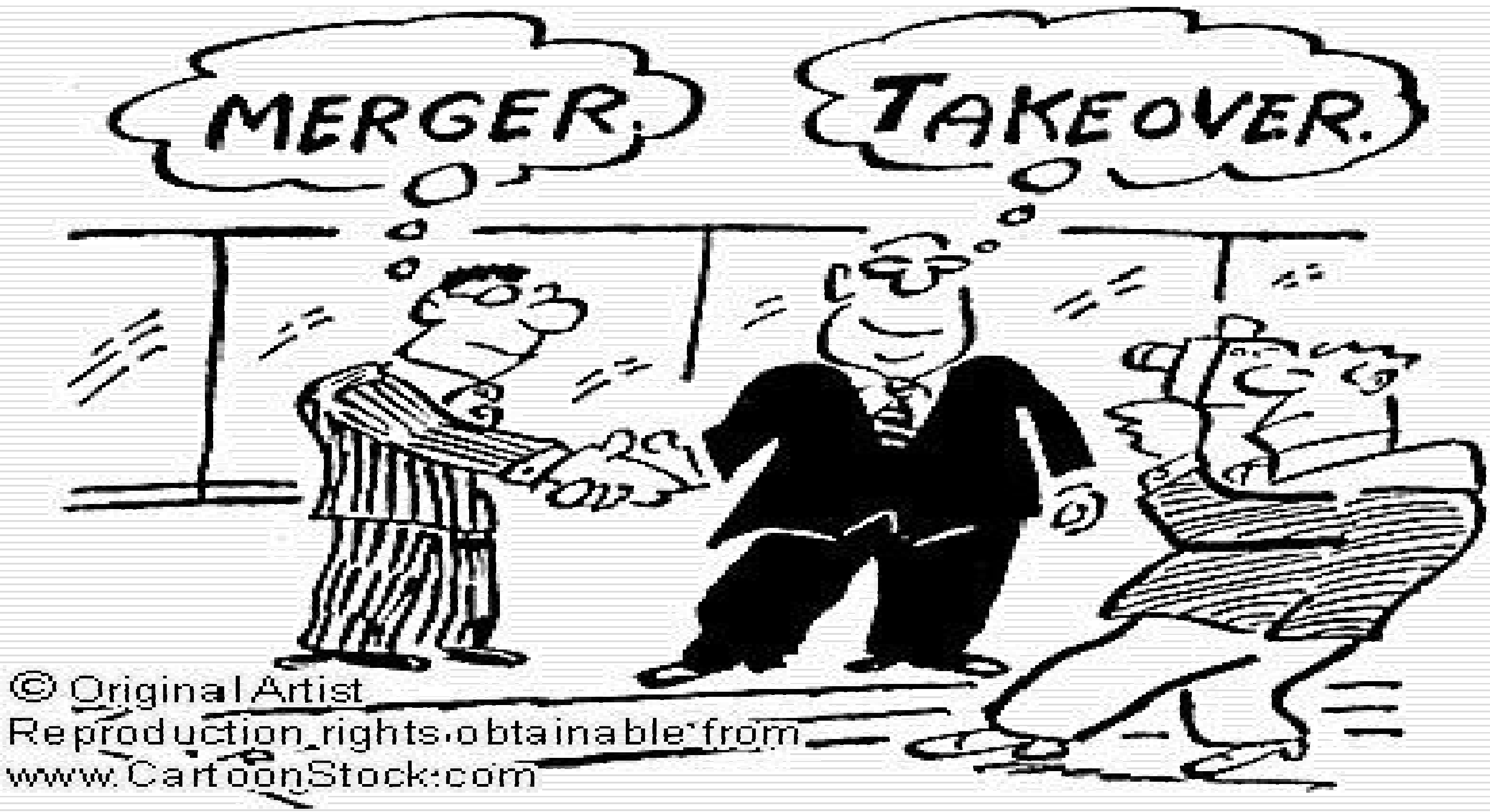
Acquisition (Cont’d)

- In the former case, the companies cooperate in negotiations; in the latter case, the takeover target is unwilling to be bought or the target's board has no prior knowledge of the offer.
- In a friendly takeover, a public offer of stock or cash is made by the acquiring firm, and the board of the target firm will publicly approve the buyout terms, which may yet be subject to shareholder or regulatory approval.
- This stands in contrast to a hostile takeover, where the company being acquired does not approve of the buyout and fights against the acquisition.

Acquisition (Cont'd)

- Acquisition usually refers to a purchase of a smaller firm by a larger one.
- Sometimes, however, a smaller firm will acquire management control of a larger or longer established company and keep its name for the combined entity. This is known as a reverse takeover.
- A type of merger used by private companies to become publicly traded without resorting to an initial public offering.

Confusion.........


MERGER.
TAKEOVER.
© Original Artist
Reproduction rights obtainable from
www.CartoonStock.com

Why to Merge

- Mergers take place to:
  - diversify the areas of activities;
  - achieve optimum size of business;
  - remove certain key factors and other bottlenecks of input supplies;
  - improve the profitability;
  - serve the customer better;
  - achieve economies of scale and size, internal and external;

Why to Merge (Cont’d)

- acquire assets at lower than the market price;
- bring separate enterprises under single control; grow without any gestation period;
- and nurse a sick unit and get tax advantages by acquiring a running concern

Decision on Merger

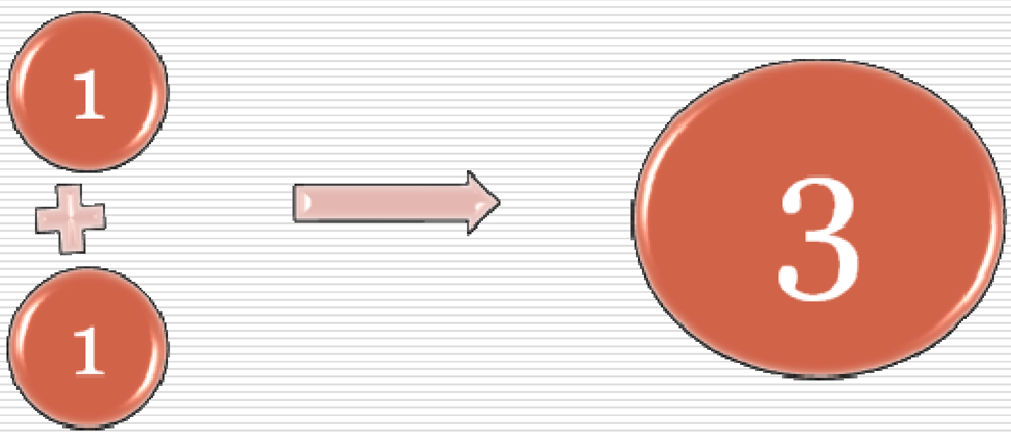
- For a firm desiring immediate growth and quick returns, mergers can offer an attractive opportunity as they obviate the need to start from ‘scratch’ and reduce the cost of entry into an existing business.
- However, this will need to be weighed against the fact that part of the ownership of the existing business remains with the former owners.
- Merger with an existing company will, generally, have the same features as an acquisition of an existing company. However, identifying the right candidate for a merger or acquisition is an art, which requires sufficient care and caliber.

Effect of Merger

Underlying Principle for M&A Transactions

$1 + 1 \neq 2$

Additional Value of "Synergy"



Types of Mergers

- Horizontal mergers
- Vertical mergers
- Conglomerate mergers
- Reverse mergers

Vertical Integration :

- Internalization of crucial forward or backward activities
  - Vertical Forward Integration – Buying a customer
    - Eg :Indian Rayon's acquisition of Madura Garments along with brand rights
  - Vertical Backward Integration – Buying a supplier
    - Eg: IBM's acquisition of Daksh

Market Intensification:

- Horizontal Integration – Buying a competitor
  - Eg: Acquisition of equity stake in IBP by IOC
- Market Extensions – New markets for Present products
  - Eg: Bharat Forge's acquisition of CDP (Germany)

Joint Venture

- JV- Marriage of convenience- concept of complementary capabilities
- Need for international technology (Mahindra & Renault)
- Sharing of costs
- When assets are difficult to separate (different divisions-saddled with the assets not needed)
- Has lesser regulatory constraints

Joint Venture (Cont'd)

- Reduced financial risks-spreading the risk between partners(ONGC and Chinese oil companies)
- Easier to enter new markets with an existing partner's presence
- JV-***Real Options***- *scale up if industry goes up or exit if it is other way.*
- Best quality with least cost: NEC(Japan) with HCL Technologies

Joint Venture (Cont’d)

- Protection of sensitive business information: Enter into NDA
- JV susceptible to: misappropriation of knowledge, hold up by the partner
- ‘Prisoners dilemma’: lack of trust , cultural differences
- Godrej-P & G, JM Financial -Morgan Stanley

M & A

Merger Waves

- Wave I (1897-1904)
  - Consisted mainly of horizontal mergers-monopolistic market structure
    - Major changes in economic infrastructure and production technologies
    - Financial factors led to the end of the wave

M & A (Cont’d)

- Wave II (1916-1929)
  - Consolidation of industries- oligopolistic industry
    - Banking and public utilities were most active industries
    - Formation of many prominent companies –General Motors, IBM etc.,
    - Wave ended due to stock market crash

M & A (Cont’d)

- Wave III (1965-1969)
  - Conglomerate merger
    - Diversification into business activities outside traditional areas.
    - Did not result in increased industrial concentration
    - Acquisitions followed poor financial performance- lack of knowledge about different industries

M & A (Cont'd)

- Wave IV (1981-1989)
  - Hostile takeover played significant role
    - Value greater than numbers
    - A period of mega mergers
    - Oil & gas, drug & medical equipment industries
    - Role of investment bankers and law firms
    - Emergence of leveraged buy outs, innovative acquisition techniques

"Harris, I want you to buy up anything that has 'dot com' in their title."

M & A (Cont’d)

- Wave V (From 1992……)
  - Strategic mergers (emphasis on strategy than quick financial gains)
  - Banking, telecommunication, IT, entertainment, media industries and more

M & A (Cont’d)

- Licensing era- indulge in unrelated diversifications
- Could survive – restriction on industry capacity
- Hostile takeovers
- Liberalization in 1991- opening up of the economy
- Greater competition, deregulation, freer imports, - new areas of concern
- Hence, restructuring of India Inc became a major theme
- Consolidation in core competent areas
- Mergers and acquisitions emerging as key corporate strategy

M & A (Cont'd)

- Theories of Mergers
  - Efficiency Theory- asset redeployment has potential for social benefits
  - Information Theory
  - Signaling Theory
  - Agency & Managerial
  - Market Power
  - HUBRIS HYPOTHESIS(mergers happen even if the current market value reflects true value)

Terminologies

Asset Stripping

The process of buying an undervalued company with the intent to sell off its assets for a profit.

The individual assets of the company, such as its equipment and property, may be more valuable than the company as a whole due to such factors as poor management or poor economic conditions.

Seeking a profit by buying a company, often when the market price is below the value of the assets, and then selling off all or some of the assets.

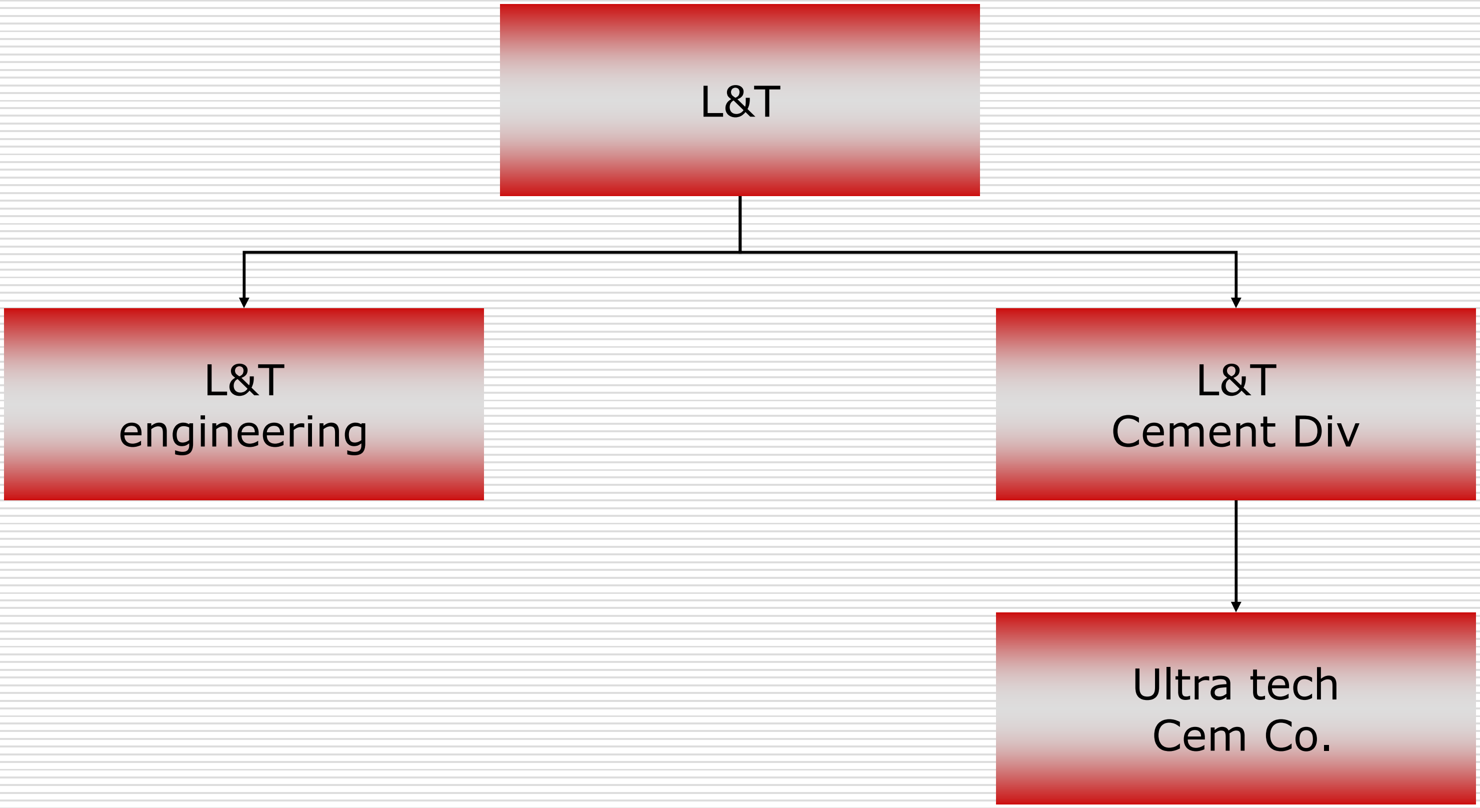
Dawn Raid

- During a dawn raid, a firm or investor aims to buy a substantial holding in the takeover-target company’s equity by instructing brokers to buy the shares as soon as the stock markets open.
- By getting the brokers to conduct the buying of shares in the target company (the “victim”), the acquirer (the “predator”) masks its identity and thus its intent.
- The acquirer then builds up a substantial stake in its target at the current stock market price.
- Because this is done early in the morning, the target firm usually doesn't get informed about the purchases until it is too late, and the acquirer now has controlling interest.

Demerger or Spin Off

- During the process of corporate restructuring, a part of the company may beak up and set up as a new company and this is known as demerger.
- Zeneca and Argos are good examples in this regard that split from ICI and American Tobacco respectively

Example



Equity Carve Out

Sometimes known as a partial spinoff, a carve out occurs when a parent company sells a stake in a subsidiary for an IPO or rights offering.

- Diluting the ownership rights of original or existing shareholders by issuing new ordinary shares of a firm to new investors.

Friendly Takeover

Friendly take over, the acquirer first approaches the promoters/ management of the target company for negotiating and acquiring the Shares. Friendly takeover is for the mutual advantages of acquirer and acquired companies.

Hostile Takeover

Hostile Takeover is against the wishes of the target company’s management. Acquirer makes a direct offer to the shareholders of the target company, without the prior consent of the existing promoter / management.

Black Knight

- **Black Knight:** It is the company which makes a hostile takeover bid on the target company

White Knight

- **White Knight:** It is the potential acquirer which is sought out by a target company’s management to take over the company to avoid a hostile takeover by an undesirable black knight.

Grey knight

- A **'grey knight'** is a third firm that is not welcomed by the 'victim', seeking to exploit the situation to their own advantage.

Yellow Knight

- A **'yellow knight'** is a firm who originally seeks to launch a hostile takeover bid but then moderates its stance and negotiates on the basis of a merger - the 'yellow' being used to imply some element of 'cowardice' in the behaviour of the bidding firm who may begin to appreciate that it will not be able to 'bully' its 'victim' into submission.

White Squire

- Such a firm may not be big enough to be able to take control of another firm but may well seek to buy into the 'victim' firm to prevent the 'black knight' from being able to achieve its takeover plans.

Crown Jewels

- **Crown Jewels:** The precious assets in the Company are called as "Crown Jewels"to depict the greed of the acquirer under the takeover bid. These precious assets attract the raider to bid for the Company's control.

Defensive Mechanism

- **Poison Pill:** It is the strategy to make the company unattractive to the acquirer. One of the strategies is to increase the debt component in the capital structure of the Company i.e increasing the Debt Equity Ratio.
- **Shark Repellent:** The Companies change and amend their byelaws and regulations to be less attractive for the corporate raider company which strategy is called shark repellent Strategy. e g. shareholders.

Defensive Mechanism (Cont'd)

- **Green Mail:** This is where a large block of shares is held by an unfriendly company, which forces the target company to repurchase the stock at a substantial premium to prevent the takeover. In a takeover bid this could prove to be an expensive defense mechanism.

Macaroni Defense

- a tactic by which the target company issues a large number of debt instruments with a guarantee to redeem at a higher price in case of a takeover.
- redemption price increases -- kind of like macaroni in a pot!
- a highly useful tactic- need to be careful in issuing too much of debt –difficulty in interest payments.

People Pill

- The management team threatens to resign at the same time en masse.
- Losing a good management team could seriously harm the company and make the bidder think twice.
- the effectiveness of a people pill defense really depends on the situation.

Saturday Night Special

- This is a sudden attempt by one company to take over another . The name comes from the fact that these maneuvers used to be done over the weekends.

Break-Up Fee

- A fee that is payable to the seller or buyer if the other party backs out of a transaction after signing a letter of intent
- Penalty for causing due diligence without closing the deal.

Others

- **Window Shopper:** Likes to look, but rarely buys
- **Bottom Fisher:** Constantly hunting for bargains. Active buyer.
- **Market Share/Product Line Extender:** Most common buyer category, because fewer operating risks are involved.
- **Strategic Buyer:** seeking to diversify and redeploy assets.
- **Leveraged Buyout:** Very active sector. Financially oriented buyers

M & A- Participants

- Investment Bankers- identification of areas for restructuring, identification of buyer & sellers, negotiations
- Lawyers- Legal compliance
- Valuation experts
- Accountants



M&A Process

- Developing a strategic plan
- Develop a related M & A plan
- Search target companies
- Prioritize potential companies
- Initiate contact
- Structure the deal, perform due diligence, and develop financing plan
- Develop a plan for integrating the acquired business
- Obtain all the necessary approvals, resolve post-closing issues and implement closing

Strategy


VISION
MARKETING
TRENDING
ADVANTAGE
DISTINCTNESS
MANAGEMENT
TARGETING
ANALYSIS
STRATEGY

Operational Effecetiveness Vs Strategic Positioning

- Operational Effectiveness: performing similar activities ***better than*** rivals

- Strategic positioning: performing different activities from rivals performing similar activities in ***different ways*** (South West Airlines)

- Productivity Frontier: sum of all existing best practices at a given time
- change the way of performing the activites- eliminate inefficiencies, improve customer satisfaction and adopt best practice.
- continuous improvement, empowerment, change management and ***learning organisation***
- *Competition based on OE alone is mutually destructive*

Strategic positioning

- Variety based positioning: producing or rendering only a subset of industry’s products or services.
- Needs –based positioning: group of customers with different needs at a given time or on different occasions---a tailored set of activities
- Access-based positioning: segmenting customers who are accessible in different ways. (customer geography)

- Trade offs: more of one thing necessitates less of another
- Fit & sustainability: combining activities is important

Meanings of Strategy

- Five meanings of strategy
  - Plan, consciously elaborated direction of actions
  - Pattern, clear basic line in the operation of an Organization
  - Position, certain place or location in the markets or/ and environment
  - Perspective, point of view or certain way to examine the organization or its environment
  - Plot, sequence of conducted activities which aim to

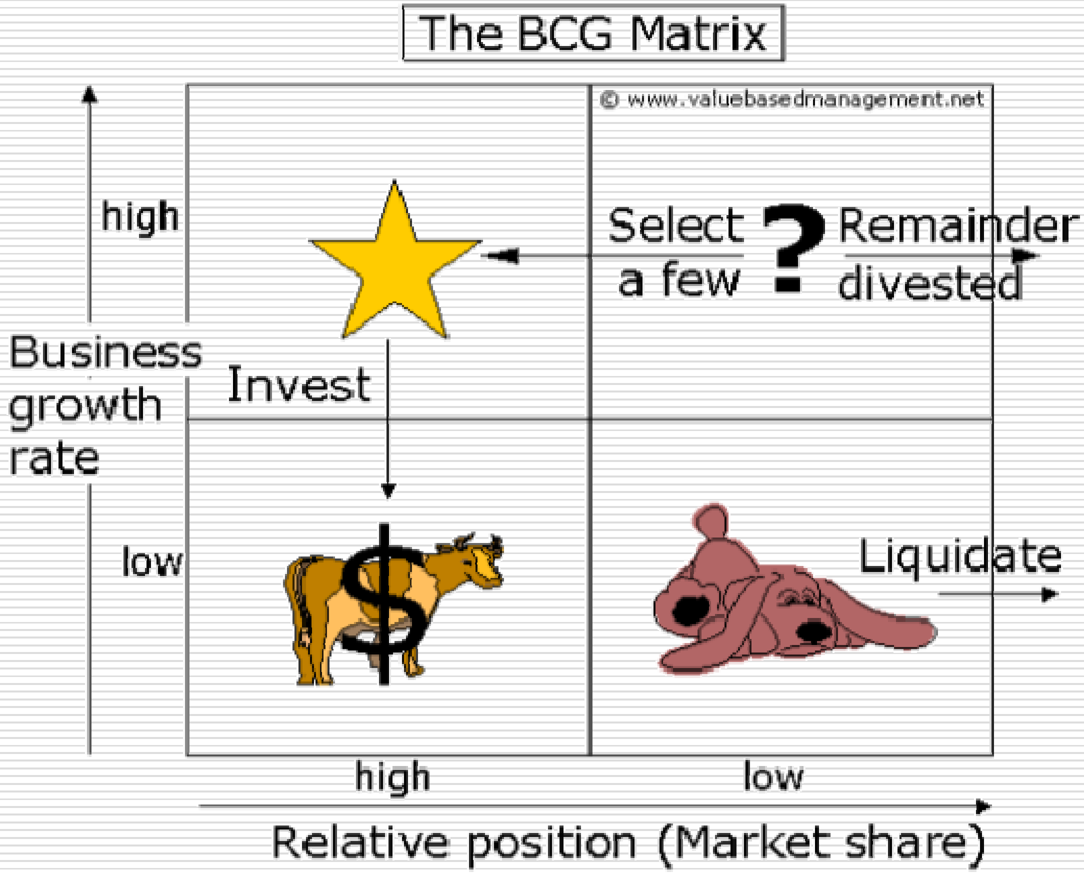
Corporate Strategic Planning

- Define Corporate Mission
- Analyze, Evaluate Current Business Portfolio
- Identify New Business Arenas to Enter/Business to exit.

BCG Approach

- **Build:** Objective is to increase the market share
- **Hold:** Objective is to preserve market share
- **Harvest:** Objective is to increase short term cash flow regardless of long term effect
- **Divest:** Objective is to sell/liquidate the business

BCG Matrix


The BCG Matrix
© www.valuebasedmanagement.net
high
Business
growth
rate
low
Invest
Select
a few
Remainder
divested
Liquidate
high
low
Relative position (Market share)

BCG matrix

- Stars- Leaders in business
- Cash cows-investments to be kept low because of lower growth rate
- Dogs- minimize the no of dogs, beware of expensive turnaround plans
- ?????????

General Electric Approach

- The Industry attractiveness index is made up of such factors as
  - market size, market growth
  - industry profit margin
  - amount of competition
  - seasonally and cyclically of demand
  - industry cost structure

General Electric Approach

- Business strength is an index of factors like
  - relative market share
  - price, competitiveness
  - product quality
  - customer and market knowledge
  - sales effectiveness
  - geographic advantages

SWOT

SWOT Analysis

Hold

Sell

Acquisitions

Strategy

- Understand your objectives:
  - Is it a defensive plan or to reach a specific growth objectives?
- Alignment is key:
  - M&A strategy should align with the overall business strategy.
- Evaluate the potential universe of opportunities:
  - define the parameters of an "ideal" deal.

Strategy (Cont’d)

- Consider culture:
  - ensure a cultural fit between the two organizations.
- Review structure and financing:
  - determine the appropriate deal structure and identify financing vehicles at the outset.

Strategy (Cont'd)

- Strategy facilitates proper positioning and move faster vis-a -vis competitors- first-mover advantage
- A solid, well-articulated strategy acts as a guidepost for effective M & As
- disciplined approach, better placed to integrate and operationalize deals to deliver shareholder value over the long term.