

Merger & Acquisition as A Business Strategy in the Backdrop of Recent Global Crisis

Dr. Neeraj Saxena*
Aijaz Ahmed Khan**

Abstract

Does a global financial slowdown increase the number of mergers or decrease it? Do you think that bad times should see an increase in the number of mergers, but at vastly reduced deal values? If you do, then you are not alone, but you are unfortunately wrong. We analyzed data put out by Merger markets, this Study from 2007 to 2009 to understand what the trends in this business are and does a global financial slowdown increase the number of mergers or decrease it? Does the size of an average merger increase or decrease because of a slowdown? Do you think that bad times should see an increase in the number of mergers, but at vastly reduced deal values (purchase prices)? If you do, then you are not alone, but you are unfortunately wrong. Acquiring, selling or merging companies is big business globally. Even in a bad year, this business hits turnovers in the thousands of billions of dollars, earning commissions, salaries and bonuses in the hundreds of millions for many of the individuals involved.. The global slowdown that we have just started coming out of, throws up statistics that are just the reverse. The number of mergers across the globe has gone down, while the average size of a deal has seen only a minor dip (ok, minor when compared to the billions of dollars we are talking about).

Keywords: Smugly, Slowdown, Merging Companies, Geographies, Economy, Icing, Recession

1. Introduction

1.1 The global picture

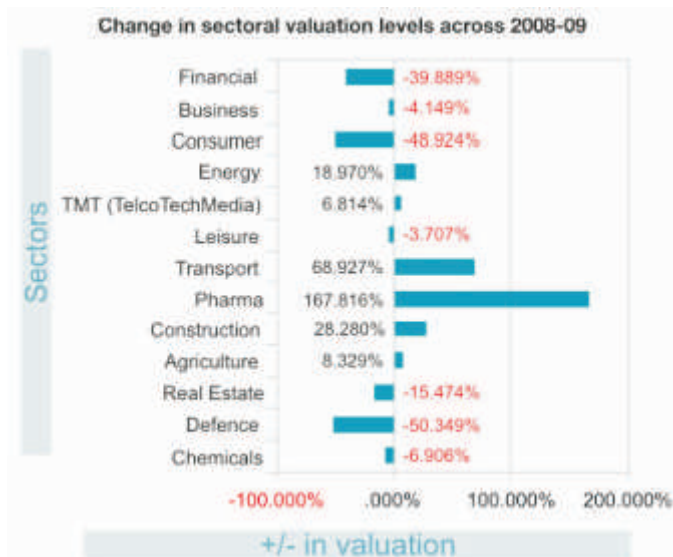
In 2007, Merger markets estimated the global M&A market to be doing around US\$ 3,600 billion worth of mergers in about 15,700 deals. Over the next three years, as the financial markets in the West melted and many industries and geographies witnessed negative growth, the number of mergers as well as the total value went down, to hit \$1,800 billion in 9,400 deals in 2009. In short, the total value of deals struck globally halved, while the number of deals came down by 40 percent, indicating that value per deal or the price paid per acquired company has more or less stayed where it was and had not come down dramatically from where it was in 2007, even as the number of deals came down to half.

1.2 In India

Compared to the global M&A scene, the Indian M&A market is not even chickenfeed. Compared to the \$1,800 billion global figure, Indian M&A activity in 2009 stood at just \$17 billion from 650 mergers and acquisitions. Going back in time, in 2007, India had witnessed 860 deals valued at \$59 billion. A quick calculation can easily tell us that the valuations have fallen drastically.

*GLBIMR, Greater Noida, U.P., India.

**Institute of Management Studies, Noida, U.P., India.



1.3 What happened in India in 2007?

It is not for no reason that the deal values in India have come down. In 2007, we find that a number of Indian companies exercised their ambitions of domestic and global acquisitions. Three deals alone involving Tata-Corus, Vodafone-Hutchison-Essar and Hindalco-Novelis involved a total of \$29 billion. These were amongst the biggest deals India has ever seen. Essar Global, United Breweries, Suzlon Energy, Vedanta Resources and GSK had combined deals worth \$6 billion.

In the global scene, there were some really big deals in 2007. Among the top deals, RBS Group with Fortis (not the Indian company by the same name) and Santander outbid Barclays to purchase ABN Amro for \$96 billion, Altria Group spun off Kraft Foods for \$61 billion while Enel-Acciona took over Endesa for \$55 billion. Four other deals including two private equity deals involved another \$150 billion.

2. Global Geographical Trends

The world economy has been witnessing some significant geographical shifts away from Europe and to a lesser extent from the Americas, towards Asia. And the M&A scene has not been

Global M&A Activity				
	Value (in \$ bn)	Volume (exact numbers)	Size of average deal (Value/ Volume) (\$ mn)	% change in value across year
2007	3635	15675	231.8979	
2008	2425	12775	189.8239	-33.2875
2009	1770	9390	188.4984	-27.0103

immune to these. While valuations in Europe more than halved in 2009, Asian economies actually registered growth in valuations. America had already seen almost an equal decline in 2008 to what Europe saw in 2009.

Deal values in North America are still comparatively larger than in the rest of the world. In 2009 they were approximately one-fifth higher than in Asia and four-fifths larger than in Europe.

3. Industry Trends

The impact of the recession has not been uniform across sectors. In 2009, the pharmaceutical sector saw the highest increase of 103 percent in actual values over 2008-09, largely because of a giant deal of \$63 billion (Pfizer buying Wyeth). Three out of the top five deals based on value of 2009 came from the pharmaceutical sector, adding a total valuation of about \$150 billion. In energy, mining and utilities, just two deals involving Rio Tinto-BHP Billiton and Exxon Mobil-XTO Energy added a combined price tag of \$98 billion. No wonder energy deals had icing on the cake in terms of best pricing.

In 2008, in comparison, it was the consumer sector that witnessed two of the biggest deals in history, with Altria Group selling off Philip Morris and In Bev buying Anheuser Busch Companies for a combined total of \$165 billion. In keeping with the theme of the times, in 2009, in terms of average deal size, the consumer sector was the worst affected if you ignore the miniscule contribution of the defense industry, with deal sizes halving. The financial services sector saw average deal size lowering from \$477 million to \$287 million (40 percent down). Consumer and financial services make up about 24 percent of total volume of M&A.

4. Did valuations actually fall because of the recession?

One interesting fact after all these discussions and analysis is that in spite of the economic depression, there has been no apparent decline in the average valuation when all geographies are considered as a whole. The decrease in the average valuation of a deal is only a miniscule \$1.3 million. What this seems to indicate is that valuation losses in one sector or geography was made up by increases in another. When Europe lost, Asia gained; when BFSI lost, pharmaceutical, energy and chemicals gained.

In fact, it was 2008 that had seen a major decline in valuation, of an average of \$42 million per deal, which means that the big impact in the M&A market had already happened in 2008. Reaction to the developing situation was immediate and there was no waiting to see how things would play out. This fact has significant learning for those contemplating M&A action.

5. India Industry Split

In value terms, it was the energy sector that led the show with \$3.5 billion worth of deals including the high-profile RIL-RPL merger, other deals involving Sanofi-Aventis, Suzlon and Oil India. Telecom followed with the Quippo-TTSL and Unitech-Telenor deals. However, it was the manufacturing sector that had the most number of deals at 76. IT/ ITeS followed with 50 deals.

Outbound deals declined in 2007 by 17 percent, grew by 48 percent in 2008, and declined again in 2009 by 53 percent. One fact which may seem to defy all notions of falling valuations is that domestic M&A deals, with a 48 percent share of the Indian

M&A pie have been negligibly affected by recession, with just 10 percent decrease in number of deals since last one year. In fact the average valuation has increased from \$5.5 million to \$6 million in 2009.

And the same trend has also been noticed in inbound deals, which have only grown over last five years, and now that the downturn is becoming upturn, they are likely to grow up at a higher rate.

6. Top Deal Makers

The top merchant banker in 2009 was Morgan Stanley with \$585.9 billion worth of deals while Goldman Sachs was the top dealmaker in terms of value, with 244 deals. They have claimed the top positions by knocking off JPMorgan as top dealmaker by value with \$726.4 billion worth of deals and UBS, which facilitated 271 deals in 2008.

7. Quarterly Trends

The financial markets place great store on quarterly trends, particularly when looking for changes to bad ones like the markets going down.

Traditionally, Q4 is the time when most deals are done. It is quite possible that most of the deals get announced in Q4 to catch the year-end deadline. Value wise, every Q4 showed a growth over the previous one starting 2003 till 2006. 2007 was the best year for M&A and the worst, as Q2 set a new record for both the number of deals and their value. And then the slide started. Q4 of 2007 could not retain its traditional spot as the best performing quarter of the year and in fact could do only half the value of Q2.

In 2009 again, Q4 was the best quarter in the year, but the whole year is behind 2008 in terms of both volumes and values. The fact that 2009 is a normal year in terms of the quarterly patterns lends hope that the M&A markets are on recovery mode.

8. Deeper lessons of Bharti/MTN Dual Listing

Reliance Infocomm and Bharti have both explored the possibility of a merger with MTN, the African telecom giant that is headquartered in South Africa. There are strong synergies in such a deal. Indian telecom companies are the world leaders in offering low cost services, and these skills would yield competitive advantage when applied in Africa. And yet, it is better to go from the foundation of MTN -- with a huge subscriber base in Africa -- instead of going into the countries of Africa and starting from scratch.

While a one-sided transaction (of Bharti purchasing MTN or of MTN purchasing Bharti) is feasible, the relative sizes of the firm suggest that the best path is a merger. A new unified firm would emerge. All existing shareholders would get shares in the merged company. The trading in both India and South Africa should continue as it has for the two erstwhile companies. In other words, it makes sense for the new company -- Bharti-MTN - - to continue to obtain equity capital from the combined base of shareholders of both countries as the two components had obtained pre-merger.

This requires a concept called "dual listing" where one company is listed in two countries. This is commonplace in the world. However, it runs afoul of India's capital controls.

This example illustrates the continuing collision between the growing sophistication of the Indian economy and the existing framework of capital controls. This story has been played out in many countries across the world. As a country obtains economic growth, and obtains a certain critical mass of a capable corporations and financial system, capital controls interfere with the process of economic growth. All countries that faced these problems have responded by dismantling capital controls.

The Bharti-MTN story is in the limelight today. But a deeper problem has been brewing for a long time. Indian companies like Tata Steel compete on the global market for steel. Capital and financial services are crucial for determining their competitiveness. When India runs a policy framework which interferes with the ability of Tata Motors to obtain the lowest cost equity or debt capital, or the best risk management services, this interferes with India's growth. High GDP growth requires embracing globalization, which involves rethinking the old arrangements for capital controls, financial sector policy and monetary policy.

One dimension of India's capital controls that merits concern is the gulf between the perspective of large firms and small firms. When Bharti faces a problem with because dual listing is difficult, it has the heft to bring this to the attention of policy makers and the media. Big companies are able to pound the corridors of RBI seeking relaxations in capital controls, hire expensive lawyers to find loopholes in capital controls and find ways to get around constraints in order to get transactions done. When India is less integrated into the global financial system, this damages debt or equity investment into small companies, but it does little damage debt or equity investment into prominent firms like Tata Steel who are on the radar of the global financial system.

These factors drive a wedge between the corporate financial structure of the top 100 companies (roughly speaking, the members of Nifty and Nifty Junior) as compared with the remaining 100,000 companies in India. The top 100 companies are able to raise equity and debt capital from overseas, get their risk management done, and access international financial services from the best financial firms in the world. The remaining 100,000 firms get the brunt of the low quality financial services that the Indian financial system doles out. This is unfair and it is inefficient for the Indian economy. It eases the life of the big 100 companies who are then subject to less competitive pressure from everyone else. It results in suboptimal utilization of resources by almost all firms, and lowers GDP growth.

There are three alternative approaches which the policy establishment can take when faced with these problems. The first consists of comprehensively taking stock of where we stand, and reforming the financial / monetary arrangements. While this is the best way to proceed, all too often, in India we take the cynical approach of thinking that comprehensive solutions are out of reach.

The second best approach is one of rapidly responding to these problems as and when they surface. When the Bharti/MTN transaction appears to be shaping up as a dual listing, MOF would rapidly swing into action and come up with all the incremental reforms (both legislative and non-legislative) required to enable dual listings. This is hard. And, there is a danger in this approach, of responding excessively to the political pressures that go along with high profile transactions, and not looking at deeper economic policy problems.

The worst possible approach that can be taken is that of sitting tight and smugly asserting that there is nothing wrong with the way India works today

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