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Amalgamation and Merger – Issues and Problems

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Abstract:

According to the *Oxford Dictionary,* the expression "merger" or "amalgamation" means "combining of two commercial companies into one" and "merging of two or more business concerns into one" respectively. 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. Amalgamation signifies blending of two or more existing undertakings into one undertaking, the blended companies losing their identities and forming themselves into a separate legal identity. The pursuit of growth and the need to access new markets have been and are propelling companies the world over to undertake mergers, amalgamations and acquisitions. We currently are expecting the fifth wave of significant M & A activity in economic history. The great wave of consolidation in the economy took place at the turn of the last century and was characterized by consolidations in several industries through horizontal mergers. Integration can be within and across industries like Horizontal, Vertical, Diagonal, & Conglomerate. M & A capabilities and resources are not only in large transaction as issue, but also in small transactions where often not enough management attention is given to the deal due to its small size and little impact on the overall performance of the company. Culture and human resources integration contributes to the major problems which need to be handled with due importance and sensitivity.

Introduction;-

The pursuit of growth and the need to access new markets have been and are propelling companies the world over to undertake mergers, amalgamations and acquisitions (mergers for brief). Indeed, this phenomenon is becoming part of the strategic architecture of many corporate bodies seeking not only to exploit existing core competencies but also to build new ones for the future. While motives or influences leading to mergers are multiple, varied and complex, there is inherent in the phenomenon of mergers, the potential for concentration of economic power.

According to the *Oxford Dictionary,* the expression "merger" or "amalgamation" means "combining of two commercial companies into one" and "merging of two or more business concerns into one" respectively. 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. Amalgamation signifies blending of two or more existing undertakings into one undertaking, the blended companies losing their identities and forming themselves into a separate legal identity.

Very often, the two expressions "merger" and "amalgamation" are taken as synonymous. But there is, in fact, a difference. 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. On the other hand, amalgamation is an arrangement, whereby the assets and liabilities of two or more companies become vested in another company (which may or may not be one of the original companies) and which would have as its shareholders substantially, all the shareholders of the amalgamating companies.

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History:-

A historical perspective on M & A activity contributes to an understanding of the strategic drivers of successful transactions. The following overview, dawn part in part from Patrick A. Gaughan's Mergers, Acquisitions and Corporate Restructurings, reveals that M & A activity over the past century has been driven by a wide range of forces, including technological innovations, economic conditions, regulatory developments, and innovations in financial products.

We currently are expecting the fifth wave of significant M & A activity in economic history. The great wave of consolidation in the economy took place at the turn of the last century and was characterized by consolidations in several industries through horizontal mergers. The Second wave took place from the mid 1910's until the stock market crash of October 1929 in US. This wave was fueled by the post World War I economic boom. Horizontal mergers continued to be the norm, yet vertical deals also played a significant role during the wave. The Third wave ran from the mid 1960's until the end of that decade, which is often referred to as the "Go-Go Years" in reference to the booming stock market at the time in US . This wave ushered in the conglomerate era in which companies made acquisition outside of their core industries. The fourth M & A wave, which occurred during the 1980's introduced the terms *Corporate raider, junk bonds and hostile takeovers* to our vocabularies. Corporate raiders relied on significant debt financing to buy companies, break them up and sell the pieces for a quick profit. The fifth wave started with 1990's and beyond. There was relatively little M & A activity at the beginning of the 1990's. As the economy came out of the 1990 – 1991 recession however M & A activity was on rise once again.

Categories of M & A Transactions

The motivations for corporate M &A activity are complex and varied. Although corporate acquisitions can be evaluated by how much share holder value has been created, one also must take into account the deals original strategic objective.

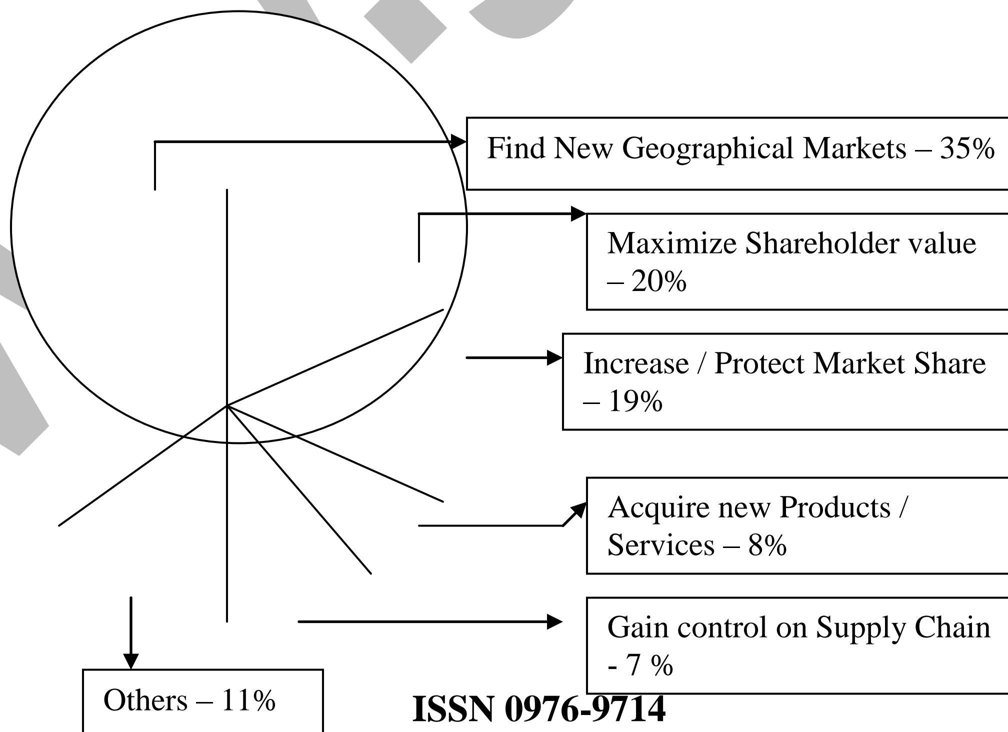

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Fig 1: - Sources: - KPMG LLP Mergers and Acquisition Global Research Report 1999

For example, in some cases and acquisition may be necessary in order for a company to remain competitive. Although such a move might not generate significant shareholder value, it might save an other wise distressed company, In such a case, even a loss in value in short term may prove to be necessary for long term success.

Integration within and across Industries:-

1. **Horizontal Integration;-** A company that is seeking to strengthen its current link or links in the value chain by acquiring competitors or similar business in a different geographical area is undertaking a strategy of horizontal integration. Many of Cisco Systems acquisitions involve niche companies whose technology and core business fill Cisco's strategy of providing a comprehensive end to end networking solution.
2. **Vertical Integration;-** A company that remains in the same industry but seeks to participate in other links in the value chain by, for example, acquiring supplier or production technology ,or acquiring dales or distribution capacity, is undertaking a strategy of vertical integration. The acquisition by the drug company MERK of the pharmaceutical benefits management company Medo is representative of this strategy.
3. **Diagonal Integration;-** A company that pursues an acquisition that involves both horizontal and vertical elements is undertaking a strategy of diagonal integration. The AOL Time Warner deal is an example of diagonal integration. It is a merger that combines content and intellectual property ownership, with distribution technology and infrastructure. The marriage may define an entirely new media industry.
4. **Conglomeration;-** Companies like ITT, which make acquisitions across disparate industries, undertake a conglomeratic strategy. It neither constitute the bringing together of competitors nor have a vertical connection. It involves a predominant element of diversification of activities. This may consist of a company deriving most of its revenue from a particular industry , acquiring companies or entities operating in other industries for one of more of the following reasons;-
    a. obtain greater stability of earning through diversification
    b. employ spare resources whether of capital or management
    c. Obtain benefit of economies of scale.
    d. Provide an outlet for the ambitions of management where anti monopoly laws may make further growth in the company's field impracticable.

Objectives Of Study:-

The following are the objectives of the study:-

1. To identify critical issues and problems arising due to integration.
2. To identify the main cultural issues post merger and amalgamation.
3. To evaluate the measures adopted post merger and amalgamation
4. To identify the reasons for failure of mergers.

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Research Methodology;-

The present study is exclusively based on secondary data. Secondary data have been collected from various magazines, libraries of various institution, journals, research publication and books. To make this study more realistic and meaningful primary data have been by gathered by interviewing, Managers and executives actively participating in the process of M & A. Primary data gives us more reliable and practical scenario to the issues.

Issues And Problems:-

M&A capabilities and resources are not only in large transactions an issue, but also in small transactions where often not *enough management attention* is given to the deal due to its

Small size and little impact on the overall performance of the company.

1. **Importance of Valuation;-** A valuation of a target company or business in needed to decide the maximum price that a purchaser should be willing to pay for control. The seller responds to the offer that a bidder makes, based on the bidder's valuation. However, a seller also could make his own valuation of a shareholding or business unit, as the minimum cash price that would be acceptable or as the target price to achieve.

   There are many mergers that have failed due to difference in the Valuation techniques used by different companies. A recent case in the Indian context is the **HLL-TOMCO** merger that took place in the 1992.

   A reason why there was large hue and cry was raised:

   a) The swap ratio that was derived and finally agreed upon was that for 2 shares of HLL, the HLL shareholders will get 15 shares of TOMCO. This was deduced on the basis of three valuation methods. Weightings were given and then a value was derived at. The valuation methods that were used were the yield method, the asset value method, the market value method.

   b) And, an independent committee arrived at a value of 5:15 swap ratio as against 2:15 as was agreed upon by the parties in merger. This was the reason behind the deal falling out.

2. **No Guiding Principle;-** As rudimentary as this sounds, we often see merging companies fail to develop a set of guiding principles linked to the merger's strategic intent. These principles should get at the very logic of the transaction—is the merger absorption of one company into another or a combination designed to take the best of both? Perfection may not be possible, but these principles will ensure that all decisions drive the combined entity in the same direction. In a best-of-both-companies transaction, for example, one principle might be: "Combine IT organizations by selecting the most up-to-date systems and deploying them across the combined entity."

3. **No definition in Companies Act;-** The terms merger and amalgamation have not been defined in the Companies Act, 1956 (hereinafter referred to as the Act) though this voluminous piece of legislation contains 69 definitions in Section 2. The concept paper recently issued by the Ministry of Company Affairs, the fate of which is still unknown, contained 100 such definitions but still stopped short of defining merger or amalgamation. The terms merger and amalgamation are

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synonyms and the term ‘amalgamation’, as per Concise Oxford Dictionary, Tenth Edition, means, ‘to combine or unite to form one organization or structure’.
The provisions relating to merger and amalgamation are contained in sections 391 to 396A in Chapter V of Part VI of the Act. Any proposal of amalgamation or merger begins with the process of due diligence, as the proposal for merger without due diligence is like entering a tunnel with darkness growing with each step. The due diligence process makes the journey see the light at the end of the tunnel – the light of wisdom to amalgamate or not. .

4. **Cultural Disconnect;-** Culture consists of the long-standing, largely implicit shared values, beliefs, and assumptions that influence behavior, attitudes, and meaning in a company (or society).This definition has several important implications:
   Culture is implicit. People who share in a culture find their culture challenging to recognize. The most insightful cultural observers often are outsiders, because cultural givens are not implicit to them.
   Culture influences how people behave and how people understand their own actions. As a result, culturally influenced beliefs and actions feel right to people, even while their implicit underpinnings make it difficult for those people to understand why they act the way they do or why other ways of acting might also be appropriate.
   Culture is resilient. Its elements are long-standing, not a matter of fads. The resilience of culture is supported by culture being implicit. It is difficult for people to recognize their own culture and how it exerts an influence on them. The staying power of culture is that it feels right to people new cultural values that are imposed on people seldom replace their underlying values and beliefs in the long run
   Challenges in the cultural dimension can result from the several different spheres of culture at once (Figure 2). In many cases, it is *very obvious from the very beginning that cultural issues will be a major challenge* that needs to be overcome (for a case study on how to handle this from the very beginning see Pineda/Kummer, 2007). The first dimension of culture is geographical culture. This is the most obvious case of culture issues in deals, i.e., cross-border deals, where the acquirer or merging partners might experience differences due to different national cultures. But also in domestic deals a clash of cultures can originate from regional differences in culture. The next dimension is corporate culture that might cause conflicts when bringing companies together. These differences in corporate culture might make integration very slow and costly and could
   create an inefficient new organization. The next evident example is the combination of companies from two different industries with different industrial cultures such as banking and insurance (the concept of bank assurance which, by the way, has failed in most cases) or the diversification or forward integration toward distributors or clients. This difference in industrial cultures can even exist within the same industry, e.g., investment banking and private banking are totally different segments that are very likely to follow completely different

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philosophies. Last but not least, there are functional/professional cultures. For example, people from IT will get along with other people from IT more easily than from finance. This creates in a PMI situation additional obstacles, as the companies will have to tackle integration across all functions.

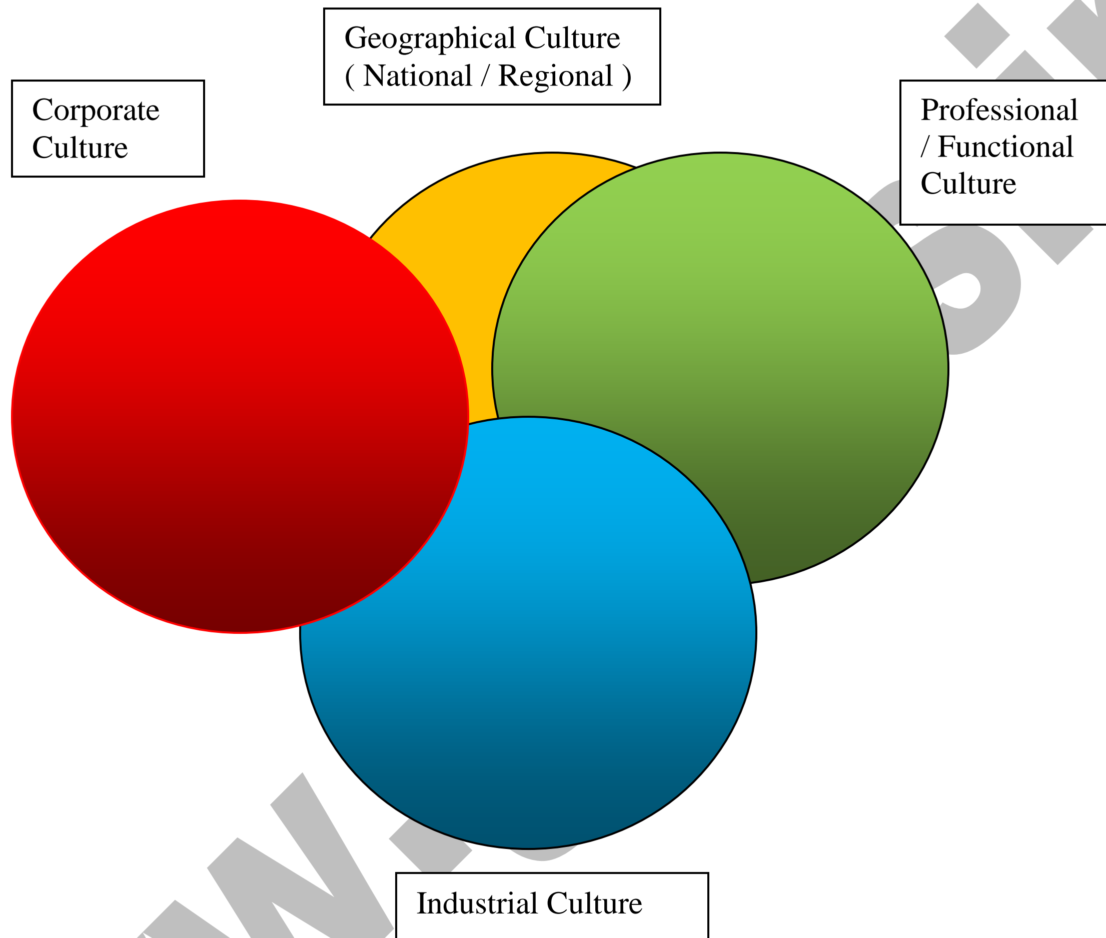

Fig 2 :The Multiple Spheres of Culture in the Corporate Environment

The actual ***cultural integration approach is interlinked to the chosen PMI approach***. There are also different ways to handle cultural integration (for different approaches see for example also Cartwright/Cooper, 1993):

• ***Cultural preservation*** keeps the entities apart and maintains their cultures.
• ***Acculturation*** adapts the culture from one of the companies.
• ***Best of both worlds*** blends the best of cultures.
• ***New culture*** tries to create a completely new corporate culture.

As these challenges in cultures are most likely to exist in every transaction, ***cultural effects should be priced into the valuation*** of the combined entity and any expected synergies (or rather dis-synergies). Pricing these cultural issues into valuation certainly is very difficult, but possible to do. This can be done for example in the following ways to quantify them in terms of:

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• The risk for the return on a transaction (a higher expectation on risk premium in valuation)
• The effect on operational productivity in the business plan (probably a drop)
• A budget to explore the cultural differences (investment during due diligence) (A budget to invest during the actual PMI implementation (in terms of amount of time, people, workshops, etc.)

Culture Effects	Resulting in
Decision making style (for example consensus contrasted with top – down)	▪ Effective integration requires rapid decision making ▪ Different decision making styles can led to slow decision making failure to make decisions, or failure to implement decisions.
Leadership style (for example: dictatorial or consultative, clear or diffuse)	▪ A shift in leadership style can generate turnover among employees who object to the change. This is especially true for top talent, who are usually the most mobile employees ▪ Loss of top talent can quickly undermine value in an integration by draining intellectual capital and market contacts
Ability to change (willingness to risk new things, compared with focus on maintaining current state and meeting current goals)	▪ Unwillingness to implement new strategies ▪ Unwillingness to work through the inevitable difficulties in creating a new company.
How people work together (for example: based on formal structure and role definitions or based on informal relationships)	Merged companies will create interfaces between functions that come from each legacy company, or new functions that integrate people from both legacy companies. If the cultural assumptions of the legacy companies are inconsistent, then processes and handoffs may break down with each company's employees becoming frustrated by their colleagues' failure to understand or even recognize how work should be done
Beliefs regarding personal "success" (for example: organizations that focus on individual "stars," or on teamwork, or where people rise through connections with senior practitioners)	Again, these differences can lead to breakdowns in getting work done. If people who believe they have to achieve goals as a team integrate with people whose notion of "success" emphasizes individual performance, the resulting situation is often characterized by personal dislike and lack of support for getting the job done

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5. **Human Resources:-** The human resource issues in the mergers and acquisitions (M&A) can be classified in two phases the pre-merger phase and the post merger phase. Literature provides ample evidence of difference in between the human resource activities in the two stages: the pre-acquisition and post acquisition period. Due diligence is important in the first phase while integration issues take the front seat in the later. The pre acquisition period involves an assessment of the cultural and organizational differences, which will include the organizational cultures, role of leaders in the organization, life cycle of the organization, and the management styles. The mergers often prove to be traumatic for the employees of acquired firms; the impact can range from anger to depression. The usual impact is high turnover, decrease in the morale, motivation, productivity leading to merger failure. The other issues in the M&A activity are the changes in the HR policies, downsizing, layoffs, survivor syndromes, stress on the workers, information system issues etc. The human resource system issues that become important in M&A activity are human resource planning, compensation selection and turnover, performance appraisal system, employee development and employee relations.

   M&A activity presents a different set of challenge for the human resource managers in both acquiring and acquired organizations. The M&A activity is found to have serious impact on the performance of the employees during the period of transition. The M&A leads to stress on the employee, which is caused by the differences in human resource practices, uncertainty in the environment, cultural differences, and differences in organizational structure and changes in the managerial styles.

   The organizational culture plays an important role during mergers and acquisitions as the organizational practices, managerial styles and structures to a large extent are determined by the organizational culture. Each organization has a different set of beliefs and value systems, which may clash owing to the M&A activity. The exposure to a new culture during the M&A leads to a psychological state called culture shock. The employees not only need to abandon their own culture, values and belief but also have to accept an entirely different culture. This exposure challenges the old organizational value system and practices leading to stress among the employees. Research has found that dissimilar cultures can produce feeling of hostility and significant discomfort which can lower the commitment and cooperation on the part of the employees. In case of cultural clash, one of the cultures that is dominant culture may get preference in the organization causing frustration and feelings of loss for the other set of employees. The employees of non-dominating culture may also get feelings of loss of identity associated with the acquired firm. In certain cases like acquisition of a lesser known or less profitable organization by a better one can lead to feelings of superiority complex among the employees of the acquiring organization. In case of hostility in the environment the employees of two organizations may develop “us” versus “them” attitude which may be detrimental to the organizational growth.

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The uncertainty during the M&A activity divert the focus of employees from productive work to issues like job security, changes in designation, career path, working in new departments and fear of working with new teams.

The human resource systems vary across organizations owing to the differences in the organizational culture, sectoral differences and national cultural differences. Another practical problem is differences in the grading or organizational structures in the systems. Since the organizational structures are different designations for the employees are used, during the integration of acquired organization the acquiring organizations need to develop a mechanism to remove the differences in the grading systems bring them at equal level, as many a times the compensation is related to the grade of employee in the organization.

The employee relations issues gain more importance in the acquisitions of manufacturing units in India. The acquiring management also needs to keep track of number of unions in the workplace and equations between them as many Indian manufacturing units have multiple unions. Hence comprehensive analysis of trade unions operating in the plant should be done. This will require study of management-union equation, employee contracts, political linkages of the unions, compensation related clauses, number of trade union and dynamics between the unions.

The impact on the employees can be divided into categories of psychological trauma, increased workload, survivor guilt and stress. The reaction of the employees can vary from anger to dejection and depression. The process of merger can have inbuilt psychological and social threats which should be identified like exodus of managers due to the perceived job insecurity. There is also fall in the morale, commitment and loyalty. The merger can lead to depression and impaired performance. The dissimilarity in the cultures can produce the feelings of hostility and significant discomfort, which impact on the commitment and cooperation on the part of employees. The cultural difference also leads to counterculture feelings where employees tend to completely reject the dominant culture of the organization. The impact of cultural shock is significant and long lasting on the employees. The initial shock is followed by employees making their own perceptions based on values and past experiences. The more dissimilar the culture is higher will be the cultural shock. The likely reactions as noted by studies are anger fear, denial frustration and depression which leads to altered behavior, reduced productivity, stress, illness, accidents , conflicts and a total lack of commitment to make merger work. The feeling of political back stabbing adds to the psychological trauma

6. **No ground rules:-** While this sounds similar to point number one, ground rules for planning provide nuts-and-bolts guidance for how the planning teams should act as they begin to put the face of the merged entity on paper. These rules should include processes for how decisions are to be made and how conflicts should be resolved.
7. **Not sweating the details:-**It's hard to believe, but detailed post-close transition plans can be lacking even when two companies are working hard and have top-level leadership closely engaged. Why? To some extent, this reflects the daunting

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complexity of any integration. It can also, however, reflect the culture of the companies and a resistance to detail and top-down accountability. The acquirer may be suffering from acquisition fatigue, management distraction, and reluctance to share information, or a simple unwillingness to follow a methodical decision timeline.

8. **Poor stakeholder outreach:-** All relevant stakeholder groups—both internal and external—must receive communication about the transaction, early and often. While employees, customers, and regulators get the bulk of the attention, there is a long list of additional stakeholders such as communities, suppliers, and the like who also need care and feeding. Management must strive to understand how these groups view the deal and how they might react to changes such as new pricing, the elimination of vendors, and adjustments in service and personnel.
9. **Overly conservative targets:-**Management must set aggressive targets from the start. This helps reinforce and clarify the transaction's guiding principles and strategic intent, specifically, how hard the integration teams need to push for cost savings *and* revenue growth. Most companies tend to focus on one or the other—but neglect to place adequate emphasis on both. Experience demonstrates that management never gets more in synergies than it requests. So, build your targets with some stretch and expect that your people will find a way to get there.
10. **Integration plan not explicitly in the financials:-**We have seen merging companies build detailed integration plans only to stop short of driving them into the combined entity's operating financials in a clearly identifiable manner. Institutional memory is short and the plans are often redone on the fly (see sin number nine). While the integration plan will evolve, you need to create financial benchmarks that can be tracked.
11. **Keeping information too close;-**There is a natural hesitancy to share information, and current regulations put pressure on what management can tell the organization without going to public disclosure. However, absent real facts, the rumor mill will fill the void. Tell employees what you can. Also, tell them what you can't tell them at the moment, why, and when you will be able to do so.
12. **Allowing the wrong changes to the plan:-**All the hard work and despite meticulously avoiding sins one through eight, some companies still miss the mark. The popular trend toward empowered line managers and decentralization carries the risk of handing off carefully designed plans to new decision makers who are not steeped in the balances and considerations that made the plan viable in the first place. Following handoff, every company needs clear decision rights about who can change the agreed-upon plans, under what circumstances, and with what approvals.

Examples along with reasons as to why do the mergers fail:-

The Jet-Sahara Fallout (absence of strategic planning)

The major reasons due to which the much talked about aviation industry felt flat on its face were:

a) The policy related to mergers and acquisition in the aircraft industry did not clearly specify the terms of transfer for airport infrastructure. The guidelines though clear on

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parking bays and landing slots, did not specify the status of aircraft hangars, check-in counters, cargo warehouses, passenger lounges and other such airport facilities.

b) Also, Jet Airways enthusiastically overvalued Air Sahara, and later wanted a discount on the original price (20 to 25 percent). This is typically a case of overvaluing a company whose business model was not robust.

Glaxo-Wellcome-Burroughs (HR issues)

Glaxo and Wellcome-Burroughs decided to merge in 1996. The Indian arms however couldn't merge in the last seven years because of high pay differential between workers of Glaxo and Wellcome in India. The workers of Wellcome were offered a one time compensation of Rs. 2 lakhs in 1998, which they refused. Further the VRS scheme launched by the firm evoked very tepid response. Since 1997 the firms have been working as independent subsidiaries in India.

ABB-Flakt Merger in India

This is a case of a domestic acquisition of Flakt by ABB in India pursuant to the cross-border (Swiss-Swedish) merger that happened at their parent level. Analyses reveal that valuations of both the companies were not done meticulously and corresponding swap ratio was biased. Synergy perceived was hardly achieved. The gain on merger was less than the capital market (BSE SENSEX) growth. Shareholders of erstwhile Flakt India lost heavily.

Effective Measures:-

The following is a gist of business issues and steps likely to be taken to follow on with the issues:-

1. If you don't understand what's driving the deal you'll have a tough time creating value, So Understand the business issues.
2. You'll pay too much and you'll need to start from square one later if your due diligence is inconsistent and ignores integration costs, thus Undertake consistent, comprehensive due diligence that incorporates integration risks and costs.
3. As the saying goes, if you don't know where you're headed any road will do, therefore Prioritize, move quickly on highest value actions, and drive all decisions based on alignment to business needs.
4. If there's no agreement or commitment on accountability from senior management—prepare for an exercise in futility, to determine guiding principles, integration structure, and confirm senior management commitment early.
5. If you think you can handle this on top of a full-time job, think again, and allocate full time resource's to manage the process.
6. If the captain(s) of the ship are missing or distracted, you'll drift aimlessly, then Select top leadership carefully and address executive comp early.
7. If you don't keep the "keepers", the value of the deal disappears, thus one should identify, retain, and engage critical talent.
8. Reward behaviors that drive your business and make sure everyone know the rules of the road, to address cultural issues and make sure your culture supports your growth strategy.
9. We've got a great strategy and plan—trouble is, no one understands it, immediately start to communicate consistently, clearly, and frequently.

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10. You only get what you measure, so Measure and monitor your progress and results.

Conclusion:-

If a company is ready to pursue an acquisition all steps in the strategy should be so plan that it leads through both sides of the M&A equation i.e. pre merger and post merger. All issues faced are equally important and strategy should be so designed to confront and overcome legacy issues during the integration process. Preparing strategy in advance is a necessity to cope with complex and time pressured significant merger activity. All soft issues should be monitored on regular basis. All communication should be clear precise and in line with the strategy and planning. PMI does not only require professional project management, but also the necessary management capabilities and resources. Companies should arrange to have enough own resources available, especially generalists with the capability to handle the complete M&A process. Although external advisors certainly can be of assistance, a certain amount of slack in organizational capacity is mandatory. The due diligence should be PMI oriented in the sense that it is broad rather than just narrowly focusing on financial aspects and helps to give a reality check of the aims of the transaction and to prepare specific integration plans and activities. These plans can finally quickly be implemented to keep employees motivated and retain key people.

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