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FUNCTIONING OF MERGERS AND ACQUISITIONS DURING COVID-19

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ABSTRACT

The sudden outbreak of the COVID-19 pandemic has affected not only the public health at large but almost all aspects of our daily life. Likewise, it has also adversely affected the global operations and the economic sector. In light of the reports related to the M&A being delayed, it is extremely important to analyse and determine the impact of the Corona Virus had on this particular sector. Post the pandemic, the acquirers will have to put special emphasis on some key areas like due diligence, business valuation, business structure and legal documentation. To that end, this article analyses the condition of the M&A sector before and after the pandemic.

INTRODUCTION

Mergers and Acquisitions is one of the lucrative modes for expansion and growth of business operation by a corporate to either take advantage of the full potential of a specific line of business or to exploit any unexplored line of business. In the past few years until the massive spread of the COVID-19, the M & A segment experienced a significant rise in the number of business deals. As per the experts, following up on a strong 2019,2020 was also predicted to be a strong year for the M & A segment.

Howsoever, the sudden breakout of the Corona Virus across the globe has completely changed the dynamics of the world economy and has brought about hitherto unseen changes in the companies, nations and amongst people all over the world. The unknown and unpredictable nature of the COVID-19 is making it extremely difficult for the companies to analyse and evaluate the uncertainty and magnitude of the potential impact it will eventually have on their business prospects. The global business environment is at present witnessing an unknown challenge which none has ever faced in the past. Although lockdowns and restrictions on social participation and gatherings are indispensable now to eradicate the current pandemic, it is resulting into large-scale disruption in cash flow issues and funding apps, supply chains, dip in consumer spending and encounters in unchartered and unimaginable territories for most business and communities. It is a hard task to foresee the consequences the global pandemic and the long term lockdown, which are affecting every aspect of our daily life. With such uncertainty, post the pandemic the focus of business owners and managers will be on the core business and its recovery, as a result of which any inorganic M & A will take a backseat.

However, on a brighter side, it may also be said that that this major COVID-19 shock may propel global M & A activity, as all the businesses will tend to raise maximum capital and seek opportunities created by adversity to acquire assets or business at more reasonable prices and also consolidate with players in the supply chain as well as erstwhile competitors, as a mutually beneficial strategy to survive, sustain and gradually grow.

SCENARIO OF THE MERGER AND ACQUISITION SECTOR BEFORE CORONA VIRUS OUTBREAK

Merger and Acquisition, popularly known as M & A is the process by which two companies gets combined and attains greater power and synergy than they would have been separate ones.

A merger occurs when two companies, which are about the same size and recognizes advantages the latter offers in terms of increasing capabilities, sales and efficiencies join hands. These two companies who choose for a merger have fair and fairly terms between them and becomes partners in a new venture. An acquisition occurs when one company decides to buy another company and involves it in his operations. The purchase may be friendly or hostile, depending on certain factors. The outcome is the same in both cases, but the relationship of the two companies is based on whether is a merger or an acquisition. Companies decide for merger and acquisition due to various strategic reasons but the most common reason for most of the business combination remains economic at the core. Merging and acquiring companies are also done for the potential growth of the business. A merger allows all the concerned companies to grow its market share. The companies also gain an advantageous position over other rival companies when they choose for merger and acquisition. Merger and acquisition also significantly reduce the cost of developing a business that will also complement the companies' strength. Acquisitions also escalate supply-chain pricing power. Also, such restructuring of business eliminates possible competitors in the market to a great extent. Buying out a company or rather acquiring a company can be a really good investment so far as the company's long term goals are concerned. However, merger and acquisition being completely two different processes also have different issues that need to be addressed. Business owners must be mindful of these issues to make the best and most appropriate decision before sealing a deal.[1]

Mergers and acquisition usually require regulatory and shareholder approvals. M & A depends on several factors which include cost and revenue synergies, strategic fit and access to talented employees. Cost and revenue synergies happen to be the most crucial factor influencing merger and acquisition. A combined company shares common functional units, investor relations and human resources. Multiple management layers are eliminated and the merged company can enjoy

[1] www.edupristine.com

additional streamlined executive structure. These actions can save improve the quality of decision making and save costs. Cost synergies are furthermore attained with the help of economies of scale which means a bigger company is capable of better negotiations with its suppliers and also effectively optimize utilizing its manufacturing potential. Talent is yet another crucial factor which is considered by companies before opting for merger or acquisition. According to the American Institute of Aeronautics and Astronautics, having access to talented managers and staff are one of the key drivers of M & A activity. Time Warner and America Online had merged because they saw the advantage of strategic fit. Time Warner would get an internet presence and AOL would convert itself into a media company.

SCENARIO OF THE MERGER AND ACQUISITION SECTOR AFTER CORONA VIRUS OUTBREAK

The novel corona virus is the single biggest reason behind the ongoing volatility of the economic market. It has imposed enormous threat to the global economy and financial markets. COVID-19 has already started exhibiting its impact on mergers and acquisitions. Different companies are facing arduous strategic choice between jamming the breaks or stepping on the gas concerning the ongoing deals. An efficacious Mergers and Acquisition strategy would be to optimally explore potential business opportunity having an appropriate plan of actions and less legal or business risks.[2]

As the crisis due to the pandemic deepens, corporates will have to put additional prominence on investment strategy. Some of the important factors that should be taken into consideration are change in business outlook, concerns regarding valuation, liquidity crunch and reallocation of surplus funds. This pandemic has brought progression of business and commerce to a grinding halt. Many businesses have closed their operations significantly and workers have been laid off. The world suffered a great recession of 2007-2009 yet recovered from the economic crisis as adversities bring about opportunities.

The pandemic has resulted in a sea change in the procedure in which mergers and acquisitions are transacted. The market before covid-19 was seller friendly and sellers had attractive valuation with plenty of debt and equity capital. In the recent days while considering a market deal multitude of factors have to be taken into consideration but companies will have to put additional importance on specific areas like due diligence, business valuation, business structure and legal documentation. Moreover the collaborating tools and financial advisors need to adapt themselves to the changed environment. Since corona virus flipped the market of mergers and acquisitions, the facet of due diligence is of utmost importance. The company while carrying out the due diligence process must properly contemplate the valuation business which includes evaluation of revenue flow, business performance and legal or business risks. Due diligence process holds a

[2] www.latestlaws.com

special significance during the COVID-19 times. In a world where physical contact is impossible, it is the process of due diligence that help the buyers to know sellers' management and alternative planning mechanism. It also gives insights about the key employees that whether adequate employees are there to successfully carry out the operation and are susceptible to the virus. This process also provides a wide range of information regarding sellers' liquidity and capacity to pay long term debts, financial positions of the sellers' key customers, dependence of sellers on geographic region affected by the corona virus and risks involved with collectability of account receivables along with solvency or going concern risks. Due diligence process also imparts knowledge about the sellers concerning their conformity with the health and safety laws in the light of danger inflicted by the pandemic and how much advantage it can take under the Coronavirus Aid Relief and Economic Security (CARES) Act. [3]

The company must also put special importance on Force Majeure provisions. The term Force Majeure has been defined in Black's Law Dictionary as "an event or effect that can be neither anticipated nor controlled. It is a contractual provision allocating the risk of loss if performance becomes impossible or impracticable especially as a result of an event that the parties could not have been anticipated or controlled."[4] Indian Statutes do not explicitly mentions about force majeure provisions but Section 32 of the Indian Contract Act 1872 mentions about contingent contract which implies a contract is contingent on the occurrence of an event which event becomes impossible making the contract void.[5] A force majeure clause in a contract includes act of god, war, terrorism, earthquake, hurricane, act of government, explosions, fire, plague or epidemic. COVID-19 has impacted force majeure clauses. It renders parties exception from performing their contractual duties under a contract on happening of an event which is considered to be beyond the control of the parties. Many companies including Indian Oil and Mangalore Refineries, Adani Ports in Gujarat and IRB Infrastructure have incorporated force majeure provisions because covid-19 has caused massive disruption in business and transport which in turn affected the party's capacity to fulfil their contractual obligations.

Considering the Mergers and Acquisitions transaction, if a buyer wants to invoke the force majeure clause and terminate the settlement, it has to show that covid-19 has caused financial issues to the sellers and the company has suffered from Material Adverse Change (MAC) or Material Adverse Event (MAE).[6] On the other hand if the seller do not want the acquirer to abandon the acquisition agreement the company has to show that no MAE has occurred during the pandemic. Therefore MAC/MAE provides either party the right to terminate the contract in case of an unforeseen

[3] www.investopedia.com

[4] www.wikipedia.org

[5] Elements of Mercantile Law by N.D.Kapoor

[6] www.lexology.com

circumstances.

EFFECT ON DEAL MAKING

In the world of uncertainty posed by corona virus the impact on deal making is not consistent. Industries like hospitality, tourism, automobile and aircraft product have suffered remarkably as compared to industries like online technologies, food delivery etc. Therefore, it is needless to mention that buyers would terminate the deals where that has been a direct impact whereas buyers in industries with less impact would reconsider valuation and pricing. As regard to the deals that have been signed before COVID-19 and are in the structuring stage, parties might renegotiate the acquisition agreement as the pandemic affected the sellers' ability to execute its pre-closing covenant and satisfy the buyers' closing conditions. To give impetus to deal making in this draconian crisis, the Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI) have authorized filing of applications electronically. The Competition Commission of India (CCI) has also allowed parties to file combination applications electronically and perform various discussions through video conferencing. Transactions of Mergers and Acquisitions would increase if parties place more reliance on e-execution and e-signing of the agreements and board and audit committee approvals can be acquired through video conferencing or audio visuals.

CONCLUSION

New rules and regulations regarding COVID-19 are being introduced by the governmental authorities almost every day. Hence, buyers in M&A deals should be well aware of the new rules and assets the target's compliance with, for instance rules related to the employment laws, safety rules and workplace health or data privacy rules on employees' health data or sector related restrictions.

Since a significant number of governmental officials are working remotely or were sanctioned compulsory leave due to the pandemic, there is a possibility of delays regarding governmental authorisations between the execution of the agreements and sealing of the M&A transactions. Parties must take into account such delays and extend long stop dates if possible. Currently, delays are also being observed in trade registry offices, hence parties should consider all these along with travel restrictions and the unlikeliness of physical meetings being held during the closure of the M&A transactions. They should amend the target's association as well to electronic or remote board and general assembly meeting following the closure of the transaction.