WWW.IJRPR.COM

International Journal of Research Publication and Reviews

Journal homepage: www.ijrpr.com ISSN 2582-7421

Cross Border Mergers and Acquisitions Transforming International Businesses

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ABSTRACT

Cross-border mergers and acquisitions offer a once-in-a-lifetime chance to accelerate globalization and economic growth since they are strategic and beneficial to both parties involved. Nevertheless, mergers and acquisitions have their own set of challenges, such as layoffs, negative environmental effects, foreign laws and taxation, and cultural barriers, to name a few. As a result, it's much more critical to determine whether they provide a long-term development model i.e., sustainability. The terms 'merger' and 'acquisition' refer to the process of merging two companies or assets via a series of financial agreements such as tender offers, asset purchases, and management acquisitions. People are seen to apply the phrases 'mergers' and 'acquisitions' identically, despite the fact that the two phrases have distinct connotations. The phrase 'acquisition' refers to the process of taking over a business and establishing new ownership. The term 'merger' refers to when two companies of about equal size join forces to progress as a unified force rather than independently. When both CEOs agree to combine their interests in respective firms, a merger might also entail an acquisition arrangement. With the narrowing of the world, cross-border mergers are on the rise. Furthermore, India is steadily improving its ease of doing business ratings and is increasingly becoming a preferred commercial location. The expansion of cross-border mergers has been aided by such a favourable economic climate. This paper aims to describe selective key provisions for transforming international businesses.

Keywords: Cross border, merger, acquisition, Foreign business, India.

Introduction

Cross border Mergers and Acquisitions or M&A are deals between foreign companies and domestic firms in the target country. The trend of increasing cross border M&A has accelerated with the globalization of the world economy. If we take some recent examples of cross border M&A deals, the Jet-Etihad deal and the Air Asia deal in the aviation sector in India are good examples of how cross border M&A deals need to be evaluated against the points mentioned previously.

For instance, there is both support and resistance to the Jet-Etihad deal as well as for the Air Asia deal. This has made other foreign companies weary of entering India. On the other hand, if we consider the cross border M&A deals in the reverse direction i.e. from emerging markets to the developed world, the Chinese oil major SNOPC had to encounter stiff resistance from the US Senate because of security concerns and potential issues with ownership patterns.

Of course, the Unilever takeover of its subsidiaries around the world is an example of a successful deal. The clear implications of these successes as well as failures is that there must be a process that is structured and standardized in each country and by each firm on how to approach the M&A deal. Otherwise, there are chances of hostility creeping into the process and vitiating the economic atmosphere for all stakeholders. More than this, the due diligence must be carried out before any such deals are considered.

Trompennars and Asser (2010) proposed that the idea of mergers and acquisitions and strategic alliances may be used to expand the entire world. Even during the financial crisis of 2008/2009, more 'share for share' agreements were proposed and implemented. Cross-border transactions are those in which two countries are engaged in a deal in which one of the sides provides an alluring promise of worldwide market expansion. This type of contract entails numerous legal and cultural complexities, such as a thorough understanding of foreign market dynamics and management bias in order to efficiently integrate the companies.

A typical example of a cross-border merger is the 1987 merger of Swedish Asea and Swiss Brown Boveri Inc. The resulting company grew to become the world's largest supplier in the $50 billion electric power business. Furthermore, the corporation went on to establish 850 subsidiaries. In addition, almost 1,80,000 people were discovered working in nearly 140 nations. In the present era, businesses have realized that they must function within a business environment that is characterized by interconnectedness rather than independence or sole dependence. Employees are either integrated into the new environment or laid off as a result of mergers and acquisitions. Due to the rigors of buying and selling, even the buyer can go bankrupt. However, there is a benefit to the mergers and acquisitions strategy. Mergers and acquisitions, according to Calipha et al. (2010), are the most common mode of future expansion and building long-term value.

It is well known that numerous newly amalgamated enterprises outperformed their predecessors, particularly where they were able to bear evolutionary forces. The fact that mergers and acquisitions are strategic alliances that regulate development by sharing risk makes them an attractive prospect. According to Rosinski, some authors believe there are primarily three ways for achieving expansion: organic growth, alliances, and mergers and acquisitions. Some argue that there were primarily five approaches to increase the order of cultural risk in order to expand internationally: greenfield venture, international strategic alliance, global joint venture, overseas acquisition, and finally, cross-national merger.

Knowledge, resources, human resources, technology, and, most crucially, access to the local enterprise at a lower cost are all acquired through cross-border mergers and acquisitions. (Sonenshine & Reynolds, 2014). Furthermore, owing to cross-border mergers, there are significant prospects of globalization and a significant change in the company's internal strategies. Even if the rate of success is one-third, according to Trompenaars and Asser (2010), certain companies have had success rates greater than that. Despite the fact that there are multiple kinds of deals available, such as joint ventures, real estate deals, and so on, the purchaser frequently chooses mergers and acquisitions. A regulatory difficulty or a failure to resolve pending agreements might be the cause.

The research was conducted by Harvard Business School and the CFOs of Bain and Company. The failure to build shareholder value, when earnings are less than the cost of capital, was presented as the fundamental reason for failure. Rosinski reported a stunning success in 2003. Unilever bought Bestfoods for about $25 billion in the 2000s. The transaction was one of the twenty largest mergers and acquisitions in the world that year. The major reason for the achievement was that the firms' cultural differences were recognized. If we seek to understand the rate of success of mergers and acquisitions, we may look at two of the most famous cross-national cases: Dutch Shell (1907) and Unilever (1930). It's simpler to explain why when one sees them. The smaller nations possessed the majority of the shares in both circumstances. Aside from it, two head offices were formed to deal with day-to-day difficulties and run operations. Furthermore, there was the least amount of government intrusion. According to Rosenbloom (2002), the measurable value of the deal and the number of cultural barriers or execution risks are the two most essential criteria that make mergers and acquisitions preferable.

Key Changes and Implications for Inbound Mergers

In an inbound merger, generally, the resultant entity can transfer or issue securities to any person resident outside India provided the transfer takes place as per the entry routes, pricing guidelines, sectoral caps/investment limits and reporting requirements issued by RBI. Most foreign investment in India is "automatic" i.e., where no prior investment approval is required; however, certain sectors do require permission and when the investment is beyond the scope of what is permitted automatically, it is essential to secure a government approval. The pricing varies where the investment is in listed or unlisted companies. For the former, it must be worked out according to Securities Exchange Board of India guidelines and for the latter, it must be as per internationally accepted valuation methods, which include discounted cash flow, net asset value, market price, profit earning capacity value and weighted average. If the foreign company is a joint venture or wholly-owned subsidiary of the Indian company, the transfer must conform to conditions prescribed under relevant RBI regulations.

The Act mandates that every merger must be approved by NCLT which can take about six months, though some time for potential delays should be factored in. Upon receipt of the approval, every office of the foreign entity located outside India will be deemed to be a branch office of the resultant Indian company and such branches can be funded from India, within the prescribed thresholds.

If the offshore merging companies have taken any borrowings or issued guarantees, these will become liabilities of the resultant entity which have to be recorded in its books of accounts. In fact, they will have to be treated as external commercial borrowings ("ECBs") and conform to RBI's Master Direction on ECB within two years from the approval of the merger. ECBs are commercial loans taken by Indian entities from eligible foreign entities (who could be equity holders) which must adhere to certain parameters such as minimum maturity period (3-10 years, depending on the type of borrowing), permitted and non-permitted end-uses and other conditions.

In addition to inbound mergers requiring compliance with applicable foreign exchange regulations, the Merger Regulation further clarifies that for inbound mergers where the foreign company is an overseas joint venture (JV)/ wholly owned subsidiary (WOS) of an Indian company, such foreign company should comply with the Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004) (ODI Regulation). Additionally, such JV / WOS should assess all obligations in the ODI Regulation applicable to 'winding up'. Where inbound merger results in acquisition of a step down subsidiary of a JV / WOS, such acquisition must comply with conditions relating to total financial commitment, method of funding, etc., as set out in the ODI Regulation.

The Merger Regulation now provides a period of 2 years from the date of sanction of scheme to bring overseas borrowings which are being taken on by the resultant Indian company, in line with the borrowing regulations stipulated therein. It is also now expressly clarified that end use restrictions under Foreign Exchange Management Act, 1999 (FEMA) shall not apply to such overseas borrowings. However, no remittance for repayment of such overseas borrowings can be made during the 2 year period. While removal of end use restrictions is needed from a compliance perspective, the restriction on repayment of such overseas borrowings for 2 years may impact borrowing arrangements and could become a major hurdle for inbound merger transactions.

The timeframe to sell assets not permitted to be held or acquired under FEMA has been increased from 180 days to 2 years from the date of sanction of the scheme. However, it remains to be tested whether such increased timeframe would be sufficient for sale of foreign assets in light of compliance under foreign laws, pricing, tax concerns, foreign market conditions and other factors. Currently, the resultant Indian company would have to seriously evaluate the provisions of the Foreign Exchange Management (Acquisition and Transfer of Immovable Property outside India) Regulations, 2015, to hold immovable property outside India.

The sale proceeds from sale of overseas assets is now expressly permitted to be used within the 2 year period, to extinguish any liability outside India which is not permitted to be held by the resultant Indian company.

Further, all legal proceedings pending by or against the foreign company in any court, will continue by or against the resultant Indian company after the merger.

Key Changes and Implications for Outbound merger

A person resident in India can acquire or hold securities of the resultant foreign company in accordance with relevant RBI regulations. Once the merger is approved, the guarantees or borrowings of the Indian company become liabilities of the resultant foreign company who must, consequently, repay them in accordance with approved merger scheme. For instance, if the scheme allows purchase of shares of dissenting shareholders of the Indian company, it will also become liability of the resultant company. Further, all legal proceedings pending by or against the Indian company will continue by or against the resultant foreign company after the merger.

Indian offices of the transferor Indian company will be deemed to be a branch office of the resultant foreign company. Typically, a branch is registered in India as a place of business of a foreign entity. The eligibility criteria, registration process and compliances of a branch are covered under applicable RBI regulations. Generally, a foreign entity will apply to an authorized bank to obtain approval letter to set up a branch office. However, under CMR this approval is deemed to be given provided the concerned branch conforms to all compliances prescribed by these regulations, which are not detailed here. The operations of a branch are narrower than a corporation and it cannot undertake anything outside the scope of the listed activities. These include:

- export/import of goods, provide professional consultancy services,
- do research work on resultant company's business activities,
- promote technical and financial collaboration with Indian companies,
- act as resultant company's representative,
- act as buying/selling agent of resultant company's goods in India,
- provide information technology and software development services,
- provide technical support for the goods supplied,
- represent a foreign airline/shipping company.

Despite the numerous drawbacks, certain mergers in the past appeared to be promising, such as the recent merger of Zee Entertainment Enterprises Limited (ZEEL) and Sony Pictures Network India (SPNI), the two largest media conglomerates in India. The two corporations have taken a step closer to a multibillion-dollar merger. Sony Pictures Entertainment put $1.575 billion towards the acquisition. The grand merger was completed in 2021 when the Board of Directors approved a non-binding term sheet with Sony Pictures Network India (SPNI). A non-compete agreement had been signed by the parties involved.

In the year 2021, the second biggest profitable merger in India was between Vodafone and Idea. The combined company is worth $23 billion. Despite the fact that the acquisition created a telecom behemoth, the two businesses pushed Reliance Jio and the pricing war began. The Idea-Vodafone India merger was a success, with Vodafone owning 45.1 percent of the merged company and Aditya Birla owning 26 percent. Vodafone India owns the rest of the company.

The Arcelor Mittal merger in 2006 is the third example of a great merger. Mittal Steel had made an initial proposal of $23 billion for Arcelor, which was later upped to $38.3 billion. Steel output in the worldwide market grew by 10% as a result of the agreement.

Even if the above instances appear to be positive, there have been promising mergers that failed to form an effective organization. The merging of HDFC and Max Life, for starters. This merger began in 2016 and lasted through the year 2017. Max Life is India's fourth-largest private insurance firm. It is a joint venture between Max Financial Services and Mitsui Sumitomo Insurance Company, a Japanese firm that has a 26% share in the company globally. HDFC Standard Life Insurance was a previously unlisted joint venture between (HDFC) Housing Development Financial Corporation Limited, which held 61.5 percent of the shares, and Standard Life Aberdeen PLC, which held 35 percent of the merger of Standard Life and Aberdeen Asset Management, with the remaining shares held by others.

The intended merger was not permitted by the relevant authorities and the Insurance Development Authority of India, which resulted in the collapse (IRDAI). A merger between an insurance firm and a non-insurance company is likewise prohibited under Section 35 of the Insurance Act. The planned merger between IDFC and Shriram Finance in 2017 was the second most well-known failure. A merger between a non-banking financial institution (NBFI) and an infrastructure firm was suggested. Shriram Limited, a publicly-traded company at the time of the merger, had an ownership pattern of 33.77 percent held by promoters, 5.58 percent held by domestic institutional investors, and 5.58 percent held by foreign institutional investors (22.42

percent). Dynasty Acquisitions Ltd (FPI) and Piramal Enterprise Limited are two of the investors. Shriram Group is a conglomerate based in India. Shriram Capital is the holding company for Shriram City Union Finance Ltd and Shriram Transport Finance Company Ltd, both of which are publicly traded. The primary reason for the deal's collapse was that some of IDFC's investors requested a 60% premium because they were afraid of losing their swap holdings.

The third instance is of Reliance Communication and Aircel combined. In the year 2016, the merger was started. Reliance Communication Ltd is a listed corporation in which the Promoter and Promoter group own 59 percent, Foreign Institutional Investors own 10.09 percent, Domestic Institutional Investors own 9.84 percent, and others own 27.07 percent. Aircel was owned by two companies, Maxis Communications and Sindhya Securities & Investments, which held a 74 percent and a 26 percent interest in the company, respectively. The collapse was caused by strong opposition from creditors and the China Development Bank, as well as strong opposition from the National Company Law Tribunal (NCLT). Furthermore, the process was exceedingly time-intensive, and lastly, the tax levy was extremely exorbitant.

An effective and sustainable cross-border transaction needs careful planning, rigorous due diligence, and meticulous pre and post-deal execution by the executives. The following are some of the points that executives and transaction participants should think about during a cross-border merger and acquisition:

- Ensure that the transaction thesis and objectives guide the whole M&A process.
- Adapt the negotiation approach and playbook as needed to avoid global difficulties.
- Preventing handoff misses by combining pre-deal due diligence with pre-close preparatory activities.
- The agreement arrangement should be such that it achieves the key objectives.
- Mention the entire integration scope, method, and plan for accomplishing both start and end-state objectives openly.
- Customize a worldwide integration program that includes representatives from both the target and the acquirer for key work streams and regions/countries.
- Pay great attention to detail-oriented pre- and post-close integration planning, with dependencies and essential paths clearly stated.

Conclusion

Despite various disadvantages, businesses choose to pursue mergers and acquisitions. Following an acquisition, organizations find it simpler to manage day-to-day activities such as planning, staffing, controlling, directing, forecasting, and so on. Experienced and knowledgeable and experienced businesses are first and foremost capable of handling the deal, which leads to optimal synergy and sustainability as they improve their negotiating skills and gain a better grasp of the target. However, cross-border mergers and acquisitions might have considerable difficulties due to local regulations, taxation, and cultural differences and thus, might not be sustainable. It has become difficult for some Indian companies to repay their borrowed capital. The same is true of the prerequisites for starting a business.

Finally, there has been a huge outcry from civil society in almost all the emerging markets in recent months. This has been mainly due to public anger at crony capitalism and tiny elite cornering all the benefits. Therefore, the most essential condition before cross border M&A is actualized is that there must be regulatory scrutiny about the ownership patterns and the holding structures.

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