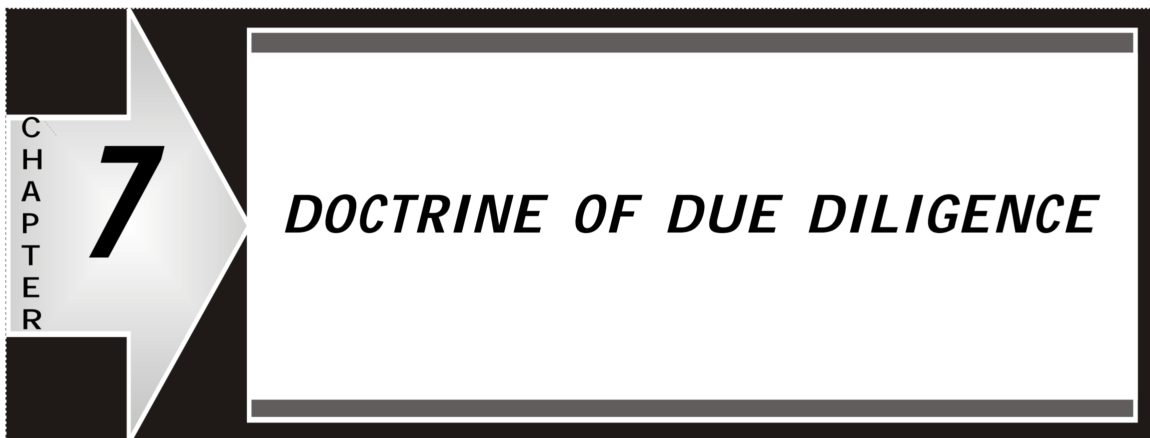

INTRODUCTION

Due diligence is the process used to determine perfect fit, but decision-makers and those who advise them would be well served not to let their due diligence become mechanical. The traditional due diligence should continue, of course, but decision-makers should be aware that there is a risk associated with not designing a due diligence process that is appropriate to the specific business targeted in each acquisition scenario, and a risk associated with not including measures that assess integrity, ethics, compliance, and governance issues. To achieve this we must stretch the parameters of due diligence.

In order to address the ethical dimension in a due diligence investigation the questionnaire as well as the questions otherwise posed to the management must be tailored with ethical issues in mind. New questions may need to be added and the answers to the traditional questions be considered in an ethical perspective. Furthermore, it needs to be considered which individuals are to be subject to interviews. In addition to the management traditionally involved, it may be appropriate to include also employees on a non-executive level as well as suppliers and customers. Finally, the report on the findings needs to reflect and highlight the ethical dimension in a proper manner.

In evaluating the outcome of the due diligence questions it is important to establish not only whether there is a risk for monetary damage, but also the risk for any non-monetary damage which in a long-term perspective may result also in considerable monetary damage. In any due diligence investigation, it is important to understand the business as well as the environment and market in which the target is acting. This is becoming even more critical when the task also includes identifying and quantifying ethical risks.

Due diligence questions which particularly address the ethical issues may include some of the points raised below. The questions do of course have to be further tailored in light of the nature of the target's business, etc.

Ethical Policies

- What ethical policies have been adopted by the target?
- What values are reflected by such policies and how do such values comply with the buyer's values?
- How are the policies implemented? How are the policies communicated to the individuals concerned?
- Is there a procedure for continuous reviewing and updating the policies?
- How is compliance with the policies monitored?

Employment

- Is the target a "good employer", who encourages ethical and cultural diversity, and a good mix between genders on all levels?
- Is the target an attractive work place which considers the employees a valuable asset and gives them reasonable focus?
- Is the company allowing its employees a reasonable balance between work and leisure time, offering reasonable healthcare and a salary and remuneration system which is well-grounded and communicated and recognises all types of work-related efforts?
- Is there a programme for employees who cannot be offered continued employment?

Management

- Does the company apply a system of transparency in relation to remuneration for its directors and senior management? If not what are the reasons for not doing so?
- Does the management enjoy any fringe benefits which are not openly accounted for and could, if scrutinised, give rise to negative publicity?
- How does the remuneration system compare with that of competitors?
- Are directors and management allowed to have other professional engagements?
- If so, are those engagements reported to the target company in order to ensure that they do not conflict with the ethical principles adopted by the target?

Commercial

- How is the business conducted in relation to customers, suppliers and others?
- Is there a policy against bribery and on compliance with human rights, child labour, etc.?
- Is there an environmental policy?
- Is there a policy against unfair competition?
- Is there a policy regarding transactions solely entered into to avoid or reduce tax?

Any due diligence involves advisors of various professions. However, because the ethical risks arise due to violations of norms, it is probably the legal team that is best suited to cover this area of due diligence. Nevertheless, in order to assess the impact there has to be a close co-operation with the other teams.

To conclude: The corporate scandals are well-known to all of us and the debate cannot be avoided. We also need to learn the lesson from this and apply it in the context of mergers and acquisitions. Scandal by big I.T. company in India "Satyam" in year 2008 by Ramlingam Raju and subsequently acquired by Tech-Mahindra.

Refining Valuation

Improving the preliminary valuation based on new information revealed during due diligence provides the starting point for negotiating the agreement of purchase and sale. The buyer should review the historical data of the past five years. The 5 years of the historical data should be normalised or adjusted for non-recurring gains, losses, or expenses. Non-recurring gains or losses result from either the sale of land, equipment, patents, software or copyrights. Non-recurring expenses include settlement of litigation, employee bonuses, etc. These adjustments are made to allow the buyer to normalise the irregularities in the historical information and to better understand the underlying dynamics of the business.

The normalised historical data will help the buyer project a minimum of 5 years of cash flows and adjust the projected cash flows for the amount and timing of anticipated synergy. The assumptions on which the buyer makes the projections also have to be clearly mentioned.

Structuring the Deal

Deal structuring involves meeting the needs of both the parties by dealing with issues of risk and reward by constructing an appropriate set of compensation, legal, tax and accounting structures. It is the process of identifying and satisfying most of the priority objectives of the parties involved in the transaction subject to their tolerance for risk.

The decisions made throughout the deal structuring process influence various attributes of the deal. These attributes include how the ownership is determined, how assets are transferred, how the interests of the ownership are protected, and how the risk is shared among the parties to the transaction. Other aspects like the type, number, and complexity of the documents required for closing the type of approval required, and the time needed to complete the transaction are also dictated by this document. The process starts with the determination by each party of their initial negotiating positions, potential risks, alternatives for managing risk, and tolerance for risk, and the conditions under which either of the parties would withdraw from the deal.

Due Diligence

The basic function of due diligence is to assess the benefits and the costs of a proposed acquisition by inquiring into all relevant aspects of the past, present and the predictable future of a business to be purchased. Due diligence is of vital importance to prevent "unpleasant surprises" after completing the acquisition. The due diligence should be thorough and extensive. Both the parties to the transaction should conduct their own due diligence to get the accurate assessment of potential risks and rewards.

Buyer's Due Diligence

The main objective of undertaking due diligence by the buyer is to identify and to confirm the source of value and lessen the potential liability by trying to eliminate the flaws that reduce value.

The due diligence exercise is carried out by a team of executives from the acquirer, their investment bankers, solicitors and CAs. The team should have members with experience of all dimensions of the business like finance, marketing, human resources operation, legal, etc. The members have indepth knowledge of the industry and the operations to be reviewed. The exercise should cover all material factors which are likely to affect the future of the business.

Due diligence exercise covers careful study of information in public domain like financial statements, corporate records like minutes of meetings, past prospectuses, share price movements, etc. All contracts entered into by the firm with lenders, suppliers, customers, franchisee, lease agreements, asset purchases agreements, etc., need to be carefully studied. Special attention should be given to litigations, contingent liabilities, environmental disputes, liens and encumbrances, product warranties, inter-company transactions, tax disputes, etc.

Due diligence should always be conducted in the shortest possible period in the interest of maintaining a co-operative relationship at the time of negotiations. A long and detailed due diligence, is likely to uncover all the items that the buyer will use as an excuse to lower the purchase price. Hence, there is a possibility that the seller may seek to stop the process before the appropriate time. The best possible solution is to agree to a shortened period.

Seller's Due Diligence

Though the major part of the due diligence procedure is carried out by the buyer, the seller also has to perform certain aspects of due diligence on the buyer. In such a process, the seller determines whether the buyer has the financial resources to finance the agreed purchase price.

Due diligence Report

Case study of ABS LTD.

1. Share Capital

(a) Shareholding pattern:

We are the private limited company, so we have not prepared any shareholding pattern but the list of shareholders is enclosed for last three years for your reference.

No. of shares

	Name of shareholder	2003-04	2004-05	2005-06
(1)	N Geeta	83410	145967	181683
(2)	N V K Mohan	17610	30817	55817
(3)	N V K Mohan-HUF	--	--	30000
(4)	N Bharti	10000	10000	10000
(5)	P Krishnaveni	7500	7500	7500
(6)	I Padmaja	5000	5000	5000
(7)	K Ramesh	5000	5000	5000
(8)	A Vijayalaxmi	2500	2500	2500
(9)	A Ramayya	1250	1250	1250
(10)	A Shailaja	1250	1250	1250
	Total	**133520**	**209284**	**300000**

(b) Change in shareholding pattern during last 3 years:

In year ended March 2004 there is no changes in shareholders.

In year ended March 2005 we allotted 75764 shares @ Rs. 10 each.

In year ended March 2006 additional allotment of 90716 shares @ Rs. 10 each was made.

(c) Top 10 shareholders

Top 10 shareholder as on date are as under:

(d) Check for compliance with regard to SEBI for limits on promoter shareholding. N.A.

(e) Ageing in case of share application money pending allotment: N.A.

(f) Whether there are any restrictions with regard to dividend distribution in shareholders agreement: No

(g) Whether there are any stock options of ESOPs: No

(h) Understanding the impact of conversion of debts to shares (either pending or committed conversion) N.A.

(i) Detail of issue of shares for consideration other than cash:

9139 equity shares of Rs.10 allotted in 1994.

2.Reserves and Surplus:

Detailed break-up of Reserves and Surplus:

(a) General Reserve : Rs. 490988.23

(b) Profit and Loss a/c: Rs. 3827837.45

(b) Compliance with respect to transfer of profit to Reserves as per Company Act: Yes

(c) Ageing in case of share application money pending allotment: Nil

(d) Compliance with regard to utilisation of reserves: Yes

(e) Obtain a schedule of all the reserves at the historical balance sheet dates. Analyse terms of statutory reserves. For all reserves understand the purpose and movement during the historical period.

3. Secured Loans:

(a) Break-up of secured loans :

Only Car loan from HDFC bank and balance as on 31.03.2006 Rs.168298.04

(b) Details with regard to original principal amount, rate of interest, security collateral, guarantees (by director, shareholders, related parties), repayment schedule and other major terms and conditions of the loan agreement.

Principal amount Rs. 312000.00

Rate of interest : 9.75%

Repayment schedule : Monthly installment Rs. 6537.00

(c) Check for actual payments against scheduled payment:

Total payment made from 01.04.2005 to 31.03.2006 as follows:

Principal : 58887.62

Interest : 19556.38

Total : 78444.00

(d) Check for accuracy of accounting – interest and principal: yes

(f) Look for any contingent liabilities of unrecorded liabilities associated with secured loans (look agreement): Nil

(g) In case of lease – check for scheme of accounting entries, compliance with AS19: Nil

(h) Look at confirmations for balances from the banks or financial institutions:

(i) Look out for any qualifications made by auditor in this space:Nil

(j) Obtain repayment schedule: Yes

(k) Have a look at the credit rating agency's report if any and obtain the same: N.A.

(l) Whether there were any defaults with respect to interest or principal payments during the past: Nil

(m) Whether there are any restrictive covenants contained in financing agreements, if any, with respect to change in ownership pattern:N.A.

(n) Interest accrual details:

4. Unsecured Loans:

(a) Break-up of un-secured loans: Nil

(b) Details with regard to original principal amount, rate of interest, repayment schedule and other major terms and conditions of the loan agreement, if available. Nil

(c) Distinguish between loans from related or unrelated parties:Nil

(d) Look for any contingent liabilities or unrecorded liabilities associated unsecured loans (Look at payments made, any claim from the lender) N.A.

(e) Look at confirmations for balances from various parties:Nil

(f) Look out for any qualifications made by auditor in this space: Nil

5. Deferred Tax Liability:

(a) Whether deferred tax liability or asset is recognised: Yes,

(b) Check for any qualifications made by the auditor in this respect:Yes

(c) In case deferred tax asset is recognised, take explanations from the management and representation for the same: Yes

(d) Verify whether it is in compliance with AS22.: Yes

(e) Restate the deferred tax liability/asset for any change in tax rate:Nil

6. Current Liabilities:

(a) Detail break-up of current liabilities (will be part of financials): A statement of current liabilities enclosed.

(b) Groupings:

(c) What is the payment practice, procedures and periodicity of obtaining confirmations:

Payments to vendor is made after getting approval from Managing Director and payment is made to vendor as per the terms and conditions decided with vendor and us.

(d) Ageing of creditors – obtain detail if there are any old dues payable.

(e) Explanations if there are any, write back:

(f) Confirmations:

(g) Check whether debt payable within the year is classified as current liabilities:

(h) Look for any contingent liabilities or unrecorded liabilities or case of under statement of liabilities associated with current liabilities (look at payment made, any claim from the creditor, ageing)

(i) Check whether all the statutory dues are paid in time and accuracy of payments:

Mainly PF, ESIC, TDS, Service Tax , Profession Tax are paid in time.

7.Provisions:

(a) Detail break-up of current liabilities:

(b) Grouping:

(c) Check whether company policy with regard to provision for employee retirement benefits are in compliance with GAAP:

(d) Whether provisions are made for gratuity and leave encashment and accuracy of such provision. Collect actuarial valuation certificate if available.

Gratuity insurance policy was taken.

(e) Check for adequacy of provisions –provisions for expenses, etc.

8. Contingent Liabilities:

(a) Obtain list of all contingent liabilities:

(a) Patna Consumer forum case pending.

(b) Discuss with management the status of litigation and claims and financial impact, if any, against the company: N.A.

(c) Obtain and analyse the company's firm purchase commitments, open letters of credits, foreign exchange forward contracts, bank and corporate guarantees and bill discounted: Nil

(d) Obtain details of contractual obligation and commitments such as export obligation and its fulfillment status: Nil

9. Fixed Assets:

(a) Documents relating to the ownership/title of the assets:

(A copy of agreement is enclosed)

(b) Insurance coverage details- compare total insured value with net block of the assets and comment on the adequacy of the insurance coverage.

(Copies of insurance policies is enclosed)

S. N.	Policy type	Insured amount
(a)	Special contingency insurance	15 lacs
(b)	Standard fire and standard perils policy	15 lacs
(c)	Electronic equipment insurance	5.01 lacs
(d)	Errors and Omissions insurance	1.00 crore
(e)	Car insurance	3.69 lacs

(c) Number of containers and vehicles owned:

We have only ONE Opel 1.4 GSI car.

(d) Fleet maintenance and replacement policy, annual maintenance charges: Nil

(e) Detail of warehousing space owned Nil

(e) Depreciation method/rate applied and appropriateness of rates applied:

WDA method and rates are as per Company Act.

(f) Company policy with respect to capitalisation:

(g) Company policy for writing off consumable/assets worth less than Rs. 5000/-

(h) Whether there was any re-valuation of assets during the last 3 years and obtain explanations for the same: Nil

(i) Major additions/deletions made during the year – Break-up asset class wise:

As per Balance Sheet and Fixed asset register.

(j) Frequency of physical asset verification. Obtain latest verification report and check for any discrepancies:

(k) Impairment of asset detail and check whether they are in compliance with AS 28:

(l) Trends in major repair and maintenance and maintainable capital expenditure:

(m) Understand the components of CWIP and comment on expenditure incurred, commitments already made, if any:

10. Investments:

(a) Company's policy with respect to valuation of investments and comment on the appropriateness of the same:

(b) Quoted Investment - Market value/Cost:

(a) Keynote Corporate Services Ltd.

(b) R S Corporation Bank

(c) Unquoted Investment – Financial details: Nil

(d) Diminutions in value of investment and obtain reason for the same:Nil

(e) Whether permissible by the MOA and AOA of the company:

(f) Check of any diminution in the value of investments: Nil

11. Inventories:

(a) Detail of Ownership of client inventory, if any: Nil

(b) Process in place to track and manage client inventory: Nil

(c) Accounting treatment for inventory handled, in-transit and lost: Nil

12. Debtors:

(a) Credit policy of the company:

We issue bill on monthly and bi-monthly basis and payments received Subsequently.(as per the agreement entered).

(b) Ageing analysis: Ageing statement is enclosed for your reference.

(c) Balance confirmation from major clients:

Balance confirmation letters already send to all clients and confirmations still awaited.

(d) Debtor's turnover - trend analysis.

(e) Credit policy for export sales- whether all sales done against L/C, BG or advance payment: N.A.

(f) Related party transactions: N.A.

(f) Check for adequacy of provision of bad and doubtful debts based on historical statement: N.A.

13. Cash and Bank Balances:

(a) Physical verification certificate:

(b) Balance confirmation from bank:

Bank statement enclosed.

(c) BRS sample check: Up-date BRS ready for checking.

14. Loans and Advances:

(a) Ageing analysis: Nil

(b) Related party transactions: Nil

(c) Advance to employees:

Some minor advance to employee, a copy of ledger is enclosed for all 4 employees.

(d) Detail of subsequent settlements: Nil

(e) Terms of advances:

Deduction on monthly basis

(f) Check for timely recoverability:

15. Sales:

(a) Particulars of the change in the sales (Increase/Decrease) over the last 3 years.:

F.Y.	SALES	REMARK
2003-04	16462960	Increase 46.91%
2004-05	17285012	Increase 4.9 %
2005-06	28191096	Increase 63%

(b) Breakdown of sales by service-type, key customers and geography for the last 3 years: N.A.

(c) Revenue recognition policy followed:

(d) Detail of the domestic and export sales over the last 3 years: N.A.

(e) Details of sales, sector-wise, if the demand in is dependent on another industry:

(f) Details of change in the sales quantity over the last 3 years and reasons for the same:

In F.Y. 2005-06 sales increase due to 10 IPO's handled by us.

(g) Details of change in the sales price over the last 3 years and reasons for the same:

(h) Details of intra-group revenue, if any, over the last 3 years N.A.

(i) Details of the major customers for the last 3 years for each service

We are in the service industry so all the clients are major for us.

(j) Details of key customer contracts, pricing arrangement, payment terms, penalty clauses.

(k) Reason for change in the contribution to sales from major customers.

15. Other Income:

(a) Details of composition of other income: N.A.

(b) Details of change in other income (Increase/Decrease) over the last 3 years: N.A.

(c) Reasons for the changes (if it is very significant): N.A.

16. Direct Costs:

(a) Breakdown of Direct costs for the last 3 years:

(b) Detail of key changes in direct cost breakdown if any and reason for the same:

(c) Detail of commission given to agents for the last 3 years:

F.Y.	AMOUNT
2003-04	658860
2004-05	147780
2005-06	1224500

(d) Details of revenue sharing arrangements with partners : Nil

(e) Details of direct costs incurred locally and from outside the country: N.A.

17. Overhead Costs:

(a) Breakdown of indirect costs for the last 3 years, including administrative, selling and other expenses:

(b) Head office and back office organisation structure:

(c) Detail of change in indirect costs, in any, and reasons for the same:

(d) Sales Tax paid, Sales Tax rate applicable, Sales Tax registration number, etc.: N.A.

18. Employee Remuneration:

(a) Number of employees (Permanent, Temporary, on contract, etc.):

(a) Permanent employees : 26

(b) Temporary : 31

(c) Contract : 9

(b) Breakdown of headcount by function – warehousing, drivers, sales and marketing, finance, admin and other:

(c) Average salary of the employees:

(d) Policy of increments and bonus:

Increment is given by management on yearly basis and bonus is paid by the company for last 3 year more than ONE month take home.

(e) Detail of statutory dues paid such as PF deductions, Gratuity provision, Leave encashment, TDS deductions, etc and the status of their payment:

There are no Statutory Dues Unpaid.

19. Operations:

(a) Descriptions of operations, key services offered and key outsourced activities:

(b) Description of current and historical operating capacity and utilisation:

(c) Alliances/tie-ups to handle specific areas of the supply chain:

20. Depreciation:

(a) Method used for applying depreciation:

(b) Rate of depreciation applied for each fixed asset:

21. Interest and financial charges:

(a) Financing charges for containers, trucks: N.A.

(b) Rate of interest on loans (long-term/short-term, secured/unsecured, etc.): N.A.

(c) Plans for restructuring loans with the lenders, if any: N.A.

(d) Check for accuracy of interest calculation in case of unsecured loans: N.A.

Corporate Governance Issues in Mergers and Acquisitions

Mergers and Acquisitions (M&A) are one of the most important means by which companies respond to changing conditions. Hardly a week passes without a new corporate merger or acquisition grabbing the headlines. Whether the reason is synergy, new market expansion, or reduced costs, the underlying principle is that one plus one will be greater than two.

The Oxford English Dictionary defines "merger" as the "consolidation or combination of one firm or trading company with another." The French have a good word for it: 'fusion', this conveys the emergence of a new structure out of two old ones. An "acquisition": on the other hand, is simply a purchase. Generally, the terms are used interchangeably.

Corporate governance is concerned with systems that influence how business corporations allocate resources and returns, and with the exercise of accountability to investors and other stakeholders. Specifically, a system of corporate governance shapes who makes investment decisions in a corporation, what type of decision they make, and how returns from investments are distributed. In addition, corporate governance is concerned with the form, extent and quality of disclosure of relevant business and financial information and the means by which directors project, articulate and justify the corporation's role as a socio-business organisation. Defined in this way, corporate governance is facilitated by the establishment of a system, whereby directors are entrusted with responsibilities and duties in relation to the stewardship of a company's affairs.

Good ethics and governance are not just "moral" or "compliance" issues. In the long-term, they are essential behavioural traits for the organisation that strengthen brand equity and help ensure stable growth.

In the professional literature on M&A, very little has been written about corporate governance issues and ethical dilemmas faced by the decision-makers. Yet practitioners struggle through these virtually daily. The best practitioners consciously address the ethical dimension in deal development and assiduously avoid taint that might accrue from an ethical lapse.

There is much evidence to suggest that most acquisitions and mergers result in a net benefit to the economy. There are more winners than losers Economists would say that it is a positive-sum game. Yet those who initiate such activity, the "predators", are commonly viewed as greedy, immoral and uncaring.

The M&A Process

A merger is about integrating people, activities, systems and processes in two or more entities. It is a process and a complicated one. There are the six discrete stages of the merger process. These are, in general, time sequenced, and any successful merger will probably move through all six. In fact, in appraising the success of a merger, it is useful to review whether and how well the organisations addressed and passed through these stages. However, it is important not to consider these stages as completely discrete.

Assessment And Readiness

This phase is where each party first assesses its own suitability for merger and its assets and liabilities as a partner, and then examines itself in light of a potential partner or partners. The need for effective communication-primarily internal at this point-begins here.

Negotiation

This phase is where the entities come together to determine if, and under what circumstances, a merger will occur. At this point some questions are likely to be raised in each issue area. There will be a need to communicate with both internal and external constituents about the process.

Immediate Pre-Merger

This is the often uncomfortable period between the point at which the merger decision is ratified by the boards, and the day on which the merger legally takes effect. It can often last several months, and is unique in that the organisations' futures are joined but their present identities are still separate. It is crucial to pay attention to the concerns and anxieties of the staff management, and board during this stage, as well as the impact of these concerns on the overall culture. Announcements to the public about the merger are typically made at this stage as well.

Legal Merger

This is a moment in time-the date the merger becomes legally effective. It is significant as a legal event, but it is not an actual span of time.

Immediate Post- Merger

Immediately after the merger, legally takes effect there are many changes, often great confusion, and usually high emotion. New ways of doing things have yet to be established, and true integration is just beginning. Many a merger begins to go off-track in this stage, and, once again, the first priority needs to be attending to the "people" issues.

Integration

This is the process, often lasting years, through which the entities truly become one. Full integration involves the people, programmes, and systems of the entire (merged) organisation. The process also involves considerable attention to communication, both internal and external.

To make the most of a merger and acquisition, companies need to avoid pitfalls and seize opportunities at each stage of the transaction process and beyond.

Gains from M&A

A number of groups benefit as a result of merger activity. The old shareholders benefit because they receive a premium for their stock. New shareholders benefit because they are buying stock in a company that is in the process of becoming more efficient and competitive. Those shareholders who do not tender their stock also benefit because the market value of their shares rises as a result of the tender offer.

The general public benefits because the more efficient company that results from the merger is able to reduce its prices and/or provide higher quality products and services. Employees benefit because a healthy company will be less likely to go out of business. There is some evidence to suggest that hostile takeovers have a beneficial effect on wages and employment.

The Decision to Acquire

Decision-makers must ask the question: "What am I getting myself into?"

When answering this question in the context of a target company's culture of integrity, ethics, compliance and governance, useful non-financial measures take on a subjective meaning and directly address "form, fit, and function". When a decision-maker looks at a target company, several questions arise, such as:

- Who are these people?
- How do they conduct their business affairs?
- Am I going to be able to work with them?
- Are they known for their best practices or something less flattering?
- How likely is it that they can proactively help me achieve my performance goals and expectations within a culture that is both ethical and compliant?

Governance Issues in Merger Integration

Effective M&A governance integrates several key dimensions: stewardship, resource allocation, decision facilitation and culture management.

Stewardship

Larger enterprises in particular may try to reduce the governance issue to matters of contracts alone. But much of governance is informal, embodied in day-to-day operating decisions and exchanges of critical information. Alliances need stewards, not just contract managers Excessively detailed contracts actually limit the ability of the alliance to adapt to changing conditions and often create tension and frustration from which the working relationship never recovers.

Resorce Allocation

Successful integration requires employing capital and people to make the efforts succeed, including redirecting resources as priorities change. Alliances are growing more complex, and they increasingly tap the core capabilities of each corporate parent, so flexibility in governance is the key. Changing conditions require a freer exchange of resources, especially skilled people and intellectual property.

Decision Faciliation

The complexity of alliances generally precludes governance by a single person or ad hoc committee. The flow of activity and information is simply too complex and important for narrow ownership. A better model is a

governance structure where decisions happen at various levels. Done well, such governance is not bureaucratic. It involves the right people, leverages the right skills and information, improves communication and eliminates mis-steps and misunderstandings. The overall result is faster and better decision-making.

Culture Management

Making disparate organisations work as one, committed to acting in the best interests of the venture is a tough job. Explicit actions and programmers are required to harmonise the cultures of the emerging entity.

M&A AND SHAREHOLDER VALUE

It is often said that the rationale for M&A is to create shareholder value. Many studies have shown that most mergers do in fact result in creating value for the shareholders. This is because of the following factors:

Deal Management And Governance

The first factor is better deal management and governance. Senior management today is much more in tune to shareholders' opinion and has a greater obligation to justify shareholder value than was necessary earlier. Governance has also become more strictly regulated: all stakeholders need to be taken into account when considering any possible deal.

Better Due Diligence

The second factor to have an effect on this change is that companies have learnt from mistakes made earlier, and are conducting a more rigorous due diligence before making a final decision. Through a meticulous examination of the company's finances, together with other cultural and organisational issues as well, not only can deals be priced more accurately but the differences and synergies between the two companies can also be more clearly identified. Therefore, there are fewer deals in recent mergers that have failed as management have been in a position to make more informed decisions on what is a good deal or not.

Financial Synergies And People Integration

The third factor that has had an effect on the success of M&A deals in the current merger wave is that in recent years, when looking at integration of the two companies, it no longer involves only the financial synergies. Cultural synergies are taken more seriously than they were in the previous two merger waves. Nowadays, HR issues are included much earlier in an M&A process. By identifying the people issues at the due diligence stage, companies are able to achieve swifter and more effective integration, therefore having a stronger foundation to work from when executing the integration of other operations.

SHAREHOLDERS OR STAKHOLDERS?

Our legal system recognises private property; as such a company is considered a private property with an owner - its shareholders. But as the law grants judicial personality to corporations, and a person cannot be owned in a society where slavery is prohibited, no "owner" of a corporation exists from a legal point of view. Accordingly, when shareholders are referred to as the "owner" of a company, it is not a legal claim but a description from an economic perspective.

The question, then, is whether it is fair in a social context to delegate governance of a corporation solely to shareholders, for the reason that they are the owners of the company. The key to answer this can be found in market principles.

Shareholders Bear Ownership Risk

The private property system is one in which all property is recognised as being owned by someone who has the right to control or dispose of that property, but who must also bear the responsibility for any (including adverse) consequences of that control. The owner must bear responsibility for all such eventualities, for better or worse. This is called ownership risk.

In a company limited by shares, shareholders - as a corollary of ownership - exercise governance over the company, which in turn burdens them with corporate risk. Shareholders receive the remnants of sales proceeds after subtracting various costs. This is commonly dubbed "profit," but it is essentially a leftover.

Accordingly, there could be some risk remaining in the leftover recognised as profits, which shareholders must also shoulder. In addition, employees' basic wages are fixed, terms of conditions with customers and suppliers are predetermined, and contracted interest is to be paid to creditors. This leaves only shareholders who can bear risks. There may be, however, cases in which business performance deteriorates significantly and the company becomes bankrupt, extending the risk burden to its employees and suppliers.

Seeking Shareholder Value Increases GDP

The capital market in the modern world was established to provide large corporations with capital and equity, and large companies issue a large number of shares to collect needed capital. Shares thus issued circulate, and other corporations and individual purchase and own them at their free will. As shareholders alternate constantly, it is neither efficient nor practical for them to manage a company even though they may have the right of governance of the company. Therefore, the shareholders appoint directors of the company, entrusting the board of directors with the responsibility of managing the company. Shareholders do not operate the company themselves but they exercise their governance through choosing executive directors. This is a reflection of the modern legal system acknowledging the realistic notion that shareholders are the owners of a company in economic terms.

Financial institutions purchase shares to become- institutional investors. The aim of individual or institutional investors is to increase their assets, so they hope for the value of shares, list stock prices, to rise. Directors and executive managers who are assigned by the shareholders to run the company thus, seek to maximise shareholder value.

The task of directors and executive managers is to create value for shareholders while complying with laws and other rules of society, and also respecting and catering to stakeholders. Employees need to be assured of a reasonable income, too. The sum of employees' income, interest income for creditors, and shareholder value comprises the added value of all corporation. GDP is defined as the aggregate of added value of all corporations. Thus, GDP can be increased by companies seeking maximum value for the shareholders. In other words, it is a responsibility of a company and its managers to seek shareholder value while acting in compliance with set rules. And it is the irresponsibility of shareholders, by exercising governance, to see that such management style is exercised.

Replacement of Shareholder Focus Could Create New Values

Suppose a company is engaged in a potentially profitable business but poor management is suppressing its profit, and, accordingly, stock prices. Investors, including individuals and other companies, recognising this situation could purchase a majority share of that company, and by exercising governance could replace managers or change the ways of running the business. If the company can be transformed to produce profit as expected, their share prices would rise. This is how shareholder value can be created through acquisition.

Similarly, a company sitting idly over large financial assets on their balance sheet could become a target of M&A, because the company may be regarded as badly managed for not utilising its resources productively. Then there may be cases where two companies with different business objectives could merge and enjoy a synergy effect by creating a new profitable business.

Governance Issues in Takeover Defences

Most ethical discussions of acquisitions and mergers focus on the ethical conduct of the predator. The ethical conduct of the target company's top management is often overlooked. It seems like the only group that does not benefit from an acquisition or merger is the company's present management, which stands to lose their jobs as a result of the merger. Management is the only group that stands to gain if the merger is thwarted. This causes problems because management has a fiduciary duty to its shareholders to do things that benefit shareholders. If they put their own interests above those of their employer (the shareholders) they are breaching their fiduciary duty and acting unethically. Yet, management almost uniformly resorts to such activity whenever there is a hostile takeover in the works.

Management uses a variety of defensive tactics to thwart a takeover. They sometimes run to politicians or the state legislature screaming that the predator has violated some law, which tends to place obstacles in the path of tender offers that hinder their success and efficiency. They may make the company less desirable as a takeover target by adopting a poison pill, selling the company's most attractive assets, going into debt, giving a third party lock up rights that allow it to repurchase in the event of a hostile takeover, paying a large dividend to deplete cash or awarding golden Parachute contract to management. They may resort to greenmail, which is a form of bribery using corporate assets to persuade the predator to go away.

Poison Pill

Poison pills are financial schemes made by the management to make the company a less attractive takeover target. A poison pill is a "strategic" move by a takeover-target company to make its stock less attractive to an acquirer. For instance, a firm may issue a new series of preferred stock that gives shareholders the right to redeem it at a premium price after a takeover. Such measures raise the cost of an acquisition, and cause dilution, hopefully deterring a takeover bid. A third type of poison pill, known as a people pill, is a threat that in the event of a successful takeover, the entire management team will resign at once, leaving that company without experienced leadership.

Poison pills may take several forms, many of which involve debt restructuring, preferred stock, discriminatory targeted repurchases, or poison pill rights. An important question to ask is, who benefits and who loses by the introduction of a poison pill?

The obvious losers are the potential raiders. A raider may decide not to attempt a takeover because of the poison pill. If an attempt is made, it may be unsuccessful and costly. Even if it is successful, the cost of success is higher where there is a poison pill.

The less obvious losers are the target company shareholders. Since the evidence suggests that target company shareholders tend to benefit by a takeover, thwarting a takeover by use of a poison pill (by any other means) prevents them from earning a premium on their stock. Ironically, it is the management, which is supposed to protect shareholder interests, that makes the poison pill. Another group that stands to lose by poison pills is consumers. Since the raider is prevented from making more efficient use of the assets than the present management, the company is unable to upgrade quality and reduce cost, with the result that consumers will have to pay higher prices to purchase goods or services that are of lower quality.

An even less obvious class of losers consists of the thousands of other industries that would get extra business if the target company was taken over and made to run more efficiently.

If all these groups stand to lose by the introduction of a poison pill, why are such pills introduced? Someone must gain by their introduction.

Otherwise, the poison pills would never be introduced. An easy way to find who benefits are to look at who introduces them in the first place, since it is usually the advocate that tends to benefit. The advocate of poison pills is management. It does not take long to see how management stands to benefit by the introduction of a poison pill. Poison pills decrease the chances of a successful takeover. If a takeover is successful, a high percentage of managers stand to lose their jobs. Up to 50 per cent of top management loses their jobs within three years of a takeover, according to one study. Therefore, management takes action to prevent job losses among their own group by introducing a poison pill.

Thus, it appears that management is working against the interest of its shareholders by introducing a poison pill. Yet some courts, particularly in the US, have upheld the right of management to introduce poison pills. In one case, the Delaware Supreme Court upheld the right of management to restrict the right of its shareholders to sell their stock, an interesting result in light of the fact that management is supposed to be the agent of the stockholders.

However, not all courts have ruled that management may interfere with shareholder voting rights. Some courts, even in the US, have crushed some poison pills.

Greenmail

Greenmail is a "payment of a premium to a raider trying to take over a company through a proxy contest or other means". Also known as *bon voyage* bonus, it is designed to thwart the takeover. By accepting the payment, the raider agrees not to buy any more shares or pursue the takeover any further for a specified number of years.

Greenmail is seen in the popular press as something that is evil, a bribe that is paid to a raider to prevent a takeover attempt from proceeding. The raider is seen as being unjustly enriched at the expense of the Target Company and shareholders. Greenmail is a payment top management decides to make to protect shareholders from a corporate raider. It is seen as an evil, but the lesser of two evils.

Greenmail payments do, indeed, stop takeover attempts dead in their tracks. But an economic analysis of greenmail payments raises questions as to their propriety. Since the evidence suggests that target company shareholders (as well as consumers and the economy in general) tend to benefit by takeovers, should management prevent a takeover by making greenmail payments? Rather than protecting shareholders, it appears that making greenmail payments harms shareholders, since it prevents them from obtaining the benefits that go with a takeover — primarily an increase in the price of their stock. Consumers are also harmed, since blocking a takeover prevents the new owners from using the acquired assets more efficiently, which would otherwise lead to offering higher quality products or services at lower prices. Preventing takeovers tends protect management, many of whom would lose their jobs if the takeover attempt ere successful.

Thus, it appears that management, unwittingly or not, makes greenmail payments to protect themselves against job loss, to the detriment of shareholders and consumers. They are thus, breaching their fiduciary duty to the shareholders, since they are using their position to benefit themselves at the expense of the shareholders.

Paying greenmail is actually a form of an takeover, a targeted repurchase. It could be construed as being unfair to a large group of shareholders, since it involves an offer to purchase the shares of one or a small group of shareholders at a premium, an offer that is not extended to all shareholders. Ironically, it is the greenmailer who is offering the other shareholders the opportunity to sell their shares at a premium, an offer the company's management is trying to prevent from being made or accepted.

Golden Parachutes

The subject of "golden parachutes" has become a controversial one. As takeovers become more sophisticated making it possible to take over even the largest companies, top management is no longer protected by working for a very large firm. That, plus the fact that about half the target company's top management are no longer with the company three years after the takeover, creates a tremendous amount of anxiety and gives them a strong incentive to seek ways to protect themselves in the event of a takeover.

Briefly, a golden parachute is a severance contract to compensate high-level corporate officials for losing their jobs if their company is taken over. Most commentators have seen such contracts as shareholder rip-offs because the high-level employee benefits and the shareholders don't get anything for their money. But this analysis is simplistic. There is really much more involved than initially meets the eye. There are circumstances under which shareholders can benefit by having the corporation enter into golden parachute contracts with top management employees.

One beneficial effect of golden parachute contracts is that they can help reduce the conflict of interest that would otherwise exist between top management and shareholders. Management may resist a takeover attempt that would be in the shareholders' interest because they stand to lose their jobs if the takeover is successful.

Thus, they are working against the shareholders' interests. Having a properly constructed golden parachute will eliminate or at least reduce this potential conflict of interest because management would be less likely to attempt to thwart a takeover attempt if their incomes were protected by golden parachutes.

Since the evidence suggests that takeovers are good for the stockholders of the target company, as well as for the general consuming public, it seems logical that company and government policy should be to encourage top management to negotiate takeovers that seem to be in the shareholders' best interests. A properly structured golden parachute contract reduces top management's conflict of interest, thus, any regulation that restricts or

prohibits such contracts actually works against the shareholders' interests, and the interests of the economy in general, since takeovers tend to be in the consumers' interest, too.

However, not all golden parachute contracts resolve the conflict of interest problem. Depending on how the contract is structured, it may serve to make the management more entrenched than before, which tends to work against the shareholders' interest. A well-designed contract will reduce this potential conflict of interest, whereas a badly-designed contract will do just the opposite. One way to make such contracts work for the benefit of the shareholders is to extend them to the members of the top management who would be negotiating the takeover and implementing the later restructuring. However, extending golden parachute contracts to lower level managers who would not be involved in takeover negotiations would be more difficult to justify on shareholder interest grounds. Extending too many golden parachutes raises the cost of the acquisition, thus making it less attractive to potential raiders, while not gaining any corresponding benefits for the corporation.

Another beneficial effect of golden parachute contracts is that they make it easier to attract top management. Golden parachute contracts are a form of compensation, a salary substitute, an insurance policy against job loss, and potentially a supplemental retirement plan. Absence of a golden parachute provision makes a job offer less attractive to a potential top-level Manager, and since golden parachutes are a form of compensation, companies that do not have them would probably have to offer higher salaries to entice potential top managers to join the company.

But not all golden parachute contracts are in the best interests of the shareholders. While a properly constructed contract reduces the manager's conflict of interest, an improperly structured contract will do just the opposite. If the golden parachute is too "golden," top management might be too willing to sell the company, so they may tend to take the first lifer that comes along rather than negotiate a higher price for their shareholders. managers and board members who hold a great deal of stock in the company will have less incentive to take the first offer than those who own little or no stock, so the company ,might provide incentives that encourage top management and board members to own stock in the company. Yet present insider trading laws provide a disincentive, and some top managers and board members are selling their stock so that they will not be accused of insider trading. Offering stock options and restricted stock appreciation rights that are exercisable only if control changes are one possible solution.

In the case of an acquisition or merger, the rights of the individuals launching the takeover attempt and the rights of the shareholders of the target company are violated if they are prevented or hindered from entering into a contract to buy or sell shares. When one takes a rights approach to ethics, there is no need to first measure increases or increases in efficiency or total happiness against total unhappiness before determining whether an action is ethical. Those who attempt to prevent a takeover attempt are the ones who are acting unethically, not the ones who initiated the takeover

attempt. They are using force or the threat of force (government) to prevent one group of individuals from buying shares and another group of individuals from selling their shares. Thus, they are violating both property and contract rights by preventing such transactions from taking place.

How M&A Can Lead To Governance Failure

The potential pitfalls of mergers and acquisitions (M&As) are well-known. They may include overpayment, over-estimation of synergies and - the inherent complexity of integration.

Recently, a lot of attention has been directed towards another hazard of M&As: corporate governance failures. Of course, pre-acquisition due diligence is critical to detecting governance failures before they can hurt the merging companies. As a series of current post-acquisition litigations illustrate allegations of fraud surfacing after the merger taint all merging entities and not just the one where the fraud occurred. In this respect, a rigorous pre-acquisition assessment of the internal controls and corporate governance practices of the merging businesses is clearly a step in the right direction.

Still, even the best due diligence can only tackle corporate governance failures occurring before the acquisition. The post-acquisition integration process itself can increase the likelihood of fraud and decrease shareholder protection.

The critical part of any M&A is the integration of distinct entities. Integration is a highly complex process that can promote the transfer of value-creating as well as harmful practices. Even with the best intentions, acquirers can trigger corporate governance failures that would not have occurred had the merging companies not been integrated.

Corporate governance failures caused by post-acquisition integration can occur in the short-term, during the transition period, because of weakened internal control systems and increased performance pressures. They can also occur in the longer term, during the integration period, because of the harmful transfer of inferior or inappropriate governance practices from one business to another or, in the context of cross-border acquisitions, because of shifts to weaker national legal environments which offer lower investor protection.

The Short-Term Problem

Merging companies have to cope with a rapid increase in the size, scope and breadth of control requirements, a patchwork of control systems, often widely different norms and internal labour markets. Thus, M&As often entail a chaotic transition period that is characterised by organisational turmoil, leadership change, cost-cutting and employee anxiety. During this period, employees may be left with little or no supervision due to a weakening of internal controls. In turn, this provides greater opportunities for fraud, notably among disgruntled employees.

Staff may also be subjected to greater pressure from their new management to meet aggressive business objectives in order to save their jobs and meet the expectations of the financial community. When opportunities and incentives come together, the potential for fraud is heightened.

Weakend Internal Control Systems

Acquisitions alter existing processes, procedures and relationships, and lead to a considerable amount of uncertainty and leadership confusion because of executive departures, the emergence of co-heads or a leadership void. During this period of disruption, employees are caught in a maelstrom of organisational change and do not understand where their company is heading, to whom they should report or what is expected of them. Furthermore, merging businesses rarely have similar or compatible control systems and confusion when attempting to align or rationalise them is inevitable, until new systems are established, controls are often overlooked or worked around, which opens up new opportunities for fraud.

When the M&A has been undertaken primarily to save costs, budget cuts are often imposed on functions that do not generate revenues but are important for preventing and detecting fraud, such as internal audit, employee screening and training. This leaves employees with less supervision and support. Naturally, when controls are weak and confusion is high, it is easier for employees to defend themselves and invoke "good faith" mistakes if the fraud is discovered.

At the same time, employees feel threatened during the M&A process. Acquirers commonly fail to undertake a balanced process of restructuring, and the target's employees generally pay a substantial toll.

What is more, in addition to the fear of being fired, employees at the target business may also experience pay cuts, depreciated status and fewer chances of promotion. Some may see an M&A as breaking the psychological contract between a company and the individual. Thus, employees are more likely to feel justified to commit fraud if they feel that the new company is unfair, and that they have been personally mistreated.

Pressure To Perform

On an average, acquisition gains at the announcement accrue to the target's shareholders at the expense of the acquirer's shareholders, and acquirers face pressure from the financial community to deliver rapidly on announced synergies. To cope with these pressures, merging companies often embrace the precious logic of "doing more with less".

When businesses belong to similar industries, acquirers tend to over-estimate cost synergies and take a sanguine view of the target's resources by depriving the target of its unique capabilities. Some employees may fall short of the newly stretched performance goals and may be inclined to cheat the system to protect their jobs or maintain their professional

reputation in an environment of heightened performance pressure. For example, in a 1994 landmark survey of 4,035 US employees undertaken by the Ethics Resource Center, 29 per cent of respondents reported that they felt pressured to engage in conduct that violated their companies' standards of business in order to meet business objectives.

The Long-Term Problem

While the short-term effects of M&As can be costly and traumatising, the long-term effects can be deadly. Long-term, negative impacts can stem from the harmful transfer of governance practices across merging companies or - in the context of cross-border M&As - from changes in investor protection due to the shift to a less protective legal environment.

Harmfull Transfer of Governace Practice

Integration does not necessarily lead to leveraging the best of both worlds. Integration is often a politicised process through which acquirers impose their control systems and corporate governance practices on the acquired businesses. A recent research study has shown that 76 per cent of acquirers transfer their managerial systems to target, while only 6 per cent adopt the target's managerial systems.

Transferring the acquirer's control systems and governance practices to the target can be beneficial when the target has been mismanaged and has activities with similar governance requirements to those of the acquirer. On the other hand, such a transfer can be harmful if the acquirer's governance practices are inferior to those of the target or if they do not fit the acquired businesses. The acquired business may have superior corporate governance practices, such as stricter accounting standards, more elaborated communication practices, a more clearly defined code of conduct and anti-fraud policies, better screening and compensation of employees and a more ethical corporate culture, indicating lower probability of fraud.

Even if the governance practices of the acquired business are not intrinsically superior to those of the acquirer, they may be more appropriate considering its competitive environment or internal context. When an acquirer blindly applies its inferior or inappropriate governance practices to the acquired business, out of internal politics or hubris, the target company suffers from a decreased level of internal monitoring and paired governance practices, which in turn hurt the shareholders of the newly merged entity.

Cross- Border M&A

Increasingly, Indian companies use cross-border acquisitions to broaden their 'geographical scope and access new capabilities from heterogeneous business environments. However, the act of crossing national boundaries compounds the already complex transition and integration processes of an M&A. Language barriers, cultural idiosyncrasies, and differences in market regulation, corporate codes, law codes and even counting practices naturally complicate deals and increase opportunities for abuse.

Countries also have different legal environments with varying levels of investor protection (the extent of the laws that protect investors' rights and the strength of the legal institutions that facilitate enforcement). An acquisition of a company by a foreign business triggers a shift in the law applicable to the target company. As a result, a cross-border acquisition can reduce the level of investor protection, when a target business in stronger corporate governance environment adopts the weaker governance practices of the acquirer.

Prescription for Prevention

Employees, managers, board members and shareholders need to address issues of corporate governance at all stages, from pre-acquisition due diligence to post-acquisitior integration. Here are some recommendations.

More Comprehensive Due Diligence

Assessing the quality of governance practices requires going beyond an assessment of the internal control systems. Shareholders not on the board should expect a corporate governance report as part and parcel of M&A information, addressing questions such as whether the target company supports effective governance policies, communication, company ethics and anti-fraud policies, and whether it can prove it.

Better Pricing

Value the governance issues. An acquiring business must know how to adjust the price of the potential target based on the likely costs of fraud itself and of the procedures required to alleviate it. During the negotiation process, managers should set up explicit objectives with their analysts, M&A advisers and auditors regarding their assessment of the risk of governance failure.

Minimise Leadership Confusion During The Transition Period

In the transition phase of an M&A, management should communicate immediately who is in control across the different levels of the organisation. A leadership void and confusion allows employees to ignore policies more easily.

Managers should communicate information not only on the status of the integration, but also on the increased likelihood of fraud. The fraud prevention system the acquirer has in place is likely to be challenged or ignored while the two companies restructure themselves into a single, new entity. Any steps that management can take with respect to clear policies and procedures, communication opportunities or hotlines for reporting problems will be time and effort well spent.

Diminish Employee Angst During The Transition Period

There is no point in delaying harsh measures for people who do not fit with the new business. Not only do delaying tactics generate inertia in the implementation process, but they also sow the seeds of employee dissatisfaction which ultimately increases the chances of fraud. For the remaining people, managers must also be sensitive to the increased pressures generated by the transition period.

Transfer Of Best Practices During The Integration Phase

Businesses that understand the negative effects of the transfer of systems that facilitate fraud can consciously choose to transfer the systems that deter fraud. To do so requires a fair assessment of the current governance practices and the humility (notably on the part of the acquirer) to adopt the target company's practices when they are superior.

Assess Country Governance Practices

As managers increasingly pursue cross-border acquisitions, it is important to assess the quality of governance practices in each national environment, including shareholder protection, creditor protection, accounting reporting standards and level of country corruption.

Managers of a target company from a stronger investor-protection regime can make contractual arrangements so that the merged organisation adopts their governance practices to compensate for deficiencies in the acquirer country's legal environment.

The Lessons

Merging companies must devote resources to addressing corporate governance issues associated with the acquisition process. While such efforts add costs and time to the deal, managers should bear in mind that M&As provide organisations with an opportunity to gain greater control of existing or newly acquired businesses.

Role of Regulators

Regulators set the rules and create a climate. One cannot regulate people into good behavior and much of the focus of corporate governance is about how to address dilemmas where there are no laws or specific regulations to provide guidance.

The biggest failure of the lawmakers and regulators since the rush of corporate scandals is that they have inadequately addressed the flawed incentive structure - the carrots and sticks, in simple terms - of the capital market system. The thrust of the policy response has been largely about sticks rather than carrots. Clearly penalties are needed for bad behaviour. But it is the carrot of stock price related rewards in the boardroom that is at the root of most of the corporate scandals.

There are many things that are unethical that ought to be illegal (and often after a crisis, they become so). Regulators have a role to play in this area. But there are also many things which are not illegal, but are unethical. Many of the things that went on at Enron were not illegal, but were unethical. We can probably write tighter and tighter codes for regulators to enforce, requiring the unethical to be more and more innovative, but we need to reply upon individual ethical responsibility and if we are going to rely upon it, we should ensure that we reward good ethical behavior and not punish it when it comes to promotions and compensation.

In the last decade, we have witnessed a strong trend of investment liberalisation in the developing and transition countries. This resulted in high cross-border Mergers and Acquisitions activity worldwide, driving the increase in Foreign Direct Investment (FDI) over the past decade and especially over the past few years. While industrialised countries account for a dominating 90 percent share of the value of world cross-border M&As, in the recent past, Latin America and East Asian developing countries are also witnessing a rise in cross-border M&As.

THEORY OF A MULTINATIONAL ENTERPRISE

To better understand international mergers, acquisitions and tender offers let us first take a look at the theory of a multinational enterprise.

A firm that operates in more than one country other than import/export operations is called a multinational company. The fundamental issue in the theory of a firm is what factors determine whether the firm would use external markets to operate its business or use managerial co-ordination within the firm. The cost and the revenue conditions of a firm are one of the important factors which determine whether a firm should use external markets to transact its business or use only internal managerial co-ordination. A firm uses internal managerial co-ordination rather than the external market when the costs are lower or when the net productivity is higher domestically.

Cost and revenue functions play a key role in international activities relating to issues like whether the firm has to import or export or acquire license or use joint ventures rather than have a plant abroad. A multinational company does not know the foreign labour markets, foreign suppliers, or the culture and customs of foreign lands. Hence, its costs are likely to be higher and revenue productivity lower than the local firms with which it competes. In such a case, a question arises as to why a company has to set-up a plant outside its country when it can produce in a much familiar domestic environment and sell abroad through an agent. In this context, they can also explore other contractual arrangements like licensing and joint ventures.

The theory of a multinational company believes that firms operate in foreign countries because costs are lower or revenue productivity is higher than if alternative contractual arrangements are made. When firms choose

to merge internationally, it implies that it will result in lower costs and higher productivity than alternative contractual means of achieving international goals.

Intangible assets are the most important factors that form the source of net revenue benefit to a multinational firm with plants in different countries. A firm may possess one or more of a number of intangible assets. The firm may be superior in technology or managerial knowledge. It may be a leader in repeated innovations. It may hold patents, trademarks or branded products. It may possess special competence in techniques, product differentiation or in continued improvement in product quality which are not available with every firm. In this context, according to Caves (1982), a leading researcher in multinational enterprise, it makes sense for such firms to come together and set-up multinational firms rather than sell the individual intangible assets in the multi-location activities. Such coming together would enable the multinational enterprise to get the right answers for issues such as: (i) Uncertainty about the quality of the product, (ii) Ill-defined and expensive property rights, (iii) Low cost of supply consequently leading to a threat of customer becoming a potential competitor, and (iv) Irreversible supply of the product, making inspection impossible.

Thus, multinational companies are found to a higher degree in industries where intangibles are important. Excess capacity in the intangible assets is one of the main reasons for setting up a foreign subsidiary. Availability of excess cash is also one of the motivating factors for foreign investment. High reputation or high organisational capital firms prefer to expand worldwide by direct investment rather than by licensing. Here, the inseparable reputation of the firm is the intangible asset transferred to the foreign subsidiary.

A vertically integrated multinational company usually establishes a subsidiary in the foreign country: (i) when the switching costs are high, i.e., when it is expensive to shift the buyer-seller relationships, (ii) when the information costs are high, and (iii) when the costs of negotiating and monitoring are high, etc.

Another influencing factor of international mergers is the 'tariff'. High tariffs against outside firms in a particular country result in the foreign company setting up a firm in that country. Exchange rate relationships have similar effects. A weak currency would increase the foreign direct investment in that country and a strong currency would encourage that country to invest in other countries having weaker currencies.

Motives Behinds International Mergers And Acquisitions

Many of the motives behind international mergers and acquisitions are similar to those of purely domestic transactions, while a few are unique to the international deals. Some such motives are discussed here under:

GROWTH

Growth is the most general and important motive for international mergers. Merging internationally provides an immediate growth opportunity to a firm which was once operating within a single country. There are various factors which encourage a firm to merge internationally for growth. They are:

- A firm having surplus cash flows operating in a slow growing domestic economy can invest its cash in the fast growing economy.
- Firm, which operate in a domestic market that is too small to accommodate the growth of the corporate or where the domestic markets are saturated, foreign markets.
- Overseas expansion may enable medium-sized firms to attain the size to improve their ability to compete.
- Size enables firms to achieve the economies of scale necessary for effective global competition.

TECHNOLOGY

Technology Effects Mergers in two ways:

- A technologically superior firm may make acquisitions in another country in order to exploit its technological advantage.
- A technologically inferior firm may make acquisition in another country to, enhance its competitive position both at home and abroad.

Technological superiority can be exploited very easily without a lot of cultural interference unlike specific management functions like marketing, labour relations, etc., which are environment specific and are not readily transferable to other surroundings. The acquirer may intentionally select a technologically inferior target which, because of its inferiority is losing market share and hence market value. By bringing in technology into the acquired firm, the acquirer can improve its competitive position and profitability both at home and abroad. On the other hand, the acquirer firms with surplus cash but technologically inferior can obtain the necessary technology by acquiring a firm with superior technology to remain effective as competitors on the worldwide scene.

Product Advantages

A firm that has developed a reputation for superior products in the domestic market may find acceptance from the foreign consumers as well. Hence, such firms foray into other countries to exploit the favourable market conditions of that country.

Government Policy

Government policies, regulations, tariffs and quotas play a great role in the merger and acquisition activity in a country and more significantly in cross-border deals. The exports of a country are particularly very vulnerable to the tariffs and quotas mainly implemented by the Government with an intention to protect the domestic industry. The presence of such restrictions encourages international mergers, especially when the market which is protected is large. Restrictions on exports in a country can result in increased direct investment in countries to where the goods were supposed to be exported. Occasionally, the environment and other government regulations increase the cost and also the time required to build facilities abroad. This may lead to acquisitions of companies with already existing facilities.

Changes in the Government policy can make acquisitions in various countries more or less attractive. For example, the deregulation policies followed by the Government of India have encouraged many foreign companies to acquire Indian firms over the recent years.

Rate of Exchange

Rate of exchange is another unique factor that influences international mergers and acquisitions. The relative strength or weakness of an acquirer's currency versus the target company's currency influences.

- The effective price paid for an acquisition.
- The source of financing.
- The cost of production of operating the acquired firm.
- The value of the repatriated profits to the parent company.

Further, the accounting conventions followed would also give rise to currency translation profits and losses. Thus, managing the exchange rate risk is an additional cost for doing business for a multinational firm.

Political And Economic Stability

The relative political and economic stability of a particular country plays an important role in attracting foreign buyers. Political or economic instability increases the risk factor of operating in that country for the foreign buyer.

The various political considerations which play a key role in acquiring a firm in a foreign country are:

- The frequency with which the change in the Government takes place.
- The systematic transfer of power.

- The difference between the Government policies of various administrations.
- The degree of Government intervention on subsidies, tax breaks, loan guarantees, etc

The economic factors that influence an international merger decision include:

- The low or predication inflation.
- Labour relations.
- Stability of exchange rates.

Different Labour Costs And Productivity

The labour climate country influences the cost of production in that particular country. High labour costs and/or declining productivity of labour act as entry barriers in a country. Firms aiming to decrease the cost of production tend to acquire firms in countries where the labour costs are low and/or where the productivity of labour is high.

To Follow Clients

Some service companies like banks move into other countries following their major clients. For instance, if the banks have enough clients in a particular country, it makes business sense to move to that country where its clients are present. Firms who establish their business abroad will have to be loyal to the banks of their home country. If the foreign bank does not have offices where its clients are located, it may lose its business to more convenient local banks.

Diversification

International mergers provide diversification both geographically and also by product line. When the various economies are not correlated, then international mergers reduce the earnings risk inherent in being dependent on the health of a single economy. Thus, international mergers reduce systematic risk as well as unsystematic risk.

To Assure a Source of Raw Material

It is one of the important motivating factors in a vertical merger particularly when the acquiring firm is from the domestic country which is poor in resources. Cross-border mergers are hence used to prevent the erection of barriers against import/export of raw materials.

REASONS FOR FAILURE OF MERGERS AND ACQUISITIONS

In international mergers, language barriers, different working practices and lack of cultural understanding are major obstacles faced in bringing together the workforce of the two firms behind the common vision. Some of the major reasons for the failure are:

Reality Gap

There is always a gap existing between the perception and reality. Many firms focus too much on the hard mechanics of the merger like evaluation of synergy, integration project planning, and due diligence to extract value from an acquisition. Instead managers should also concentrate more on the softer issues like selecting the right management team and resolving cultural and communication misunderstandings which are very important for the success of the merger.

Culture Clash

No two companies are alike, not just in what they do, but also in how they operate at a corporate or functional level. Some firms are very different than others. Language and culture appear to be the biggest barriers to a successful completion of the deal. Hence, mergers of companies from the same country are more likely to succeed.

The type and complexity of the cultural challenge depends on the nature of integration in the merger or acquisition. If both companies are to be fully integrated, the best inherited aspects of both the organisations should be incorporated into a single new company culture focused on achieving future business growth. Where the companies are to be run as two separate entities, cultural integration is neither wise nor necessary, yet close links to ensure mutual co-operation between two separate cultures will be essential to ensure that the deal increases the shareholder value. However, in each case, cultural factors should be incorporated into all the elements of the M&A process from pre-deal planning to post-deal implementation.

The reasons why managers must recognise and act upon critical cultural issues in global mergers and acquisitions are:

Employee Retention

Differences in language, customs and organisational belief systems often create conflicts between the employees. If employee resistance after the merger is allowed to continue, the merged company might face the risk of losing most of the key human capital which is required to execute integration and attain its corporate growth objectives.

Organisational Design

Integrating people, products and processes requires forming a new organisational structure. Designing a structure that is capable of effectively serving customers and creating shareholder value requires dealing with the cultural variables like the ways of communicating, expectations of management, etc., immediately after the merger to allow the merged company's organisation to drive its underlying strategy.

FORGING A NEW CORPORATE CULTURE

Merging companies from different countries can never be fully integrated if conflicting elements of their original cultures are allowed to continue. Creation of a global culture as opposed to merely supporting the existing ones is the critical success factor in international transactions. It must be the focus of all levels of management early on and should continue over the long-term period.

Article on Corporate Debt Restructuring : Getting into shape

Making use of debt in the operations of a company is a common practice. But during a downturn it becomes a huge burden to be carried along. In addition, the lower interest rate regime also gives companies' an opportunity to restructure debt, if not reduce it.

Debt has been a critical component in the capital structure of a company. It has been an oft used financing option for most companies be it to fund a new project, undertake massive restructuring, modernisation of plants or expanding the business. At one point or the other companies have turned towards debt in addition to equity and other options of pooling in capital. Irrespective of what the financial management theory has to say on the impact of debt on the company, it has hardly been an object of observation except in the downturn when meeting the interest requirements becomes difficult.

Attractive Alternative

Traditionally, debt has been a low-cost source of finance as compared with the equity market and usually companies have found it to their advantage that some amount of their capital requirement comes from debt. The interest paid to creditors is tax deductible in most countries. Another advantage of debt is that it does not dilute the ownership of the business and the cost is limited to the interest paid till the time the principal is to be returned back. In addition, the interference of creditors in the affairs of the business is minimal unless they supply a very large amount of the capital, which retains the operational freedom of the management in conducting business. Compared with equity where ownership is the main objective of the investors, creditors are only interested in the return of their funds and the return on investment thereon. Prior to liberalisation, companies depended heavily on institutions like IDBI, ICICI and banks for their long-

term and short-term funding requirements, respectively. But after liberalisation, the development in the debt markets has led to the use of debentures, corporate bonds and commercial paper. In addition, the decade of reforms was also a time when many businesses were on an expansion spree and the off-take of debt was good from all the various sources along with the booming equity markets.

Firms such as Steel Authority of India Ltd (SAIL) undertook huge amounts of funds for modernising their plants. Others such as ITC, Essar Steel, Tisco, etc., also took in a lot of loans for various reasons in the high interest rate regime. Arvind Mills is another example of a company, which put all its money (borrowed though) on the hope of an expanding denim market. But the party ended sooner than imagined and the markets came down spiraling thus, bringing about a downturn in the economy, a slump in both the industrial and the domestic demand. The situation brought about a heavy reduction in the revenues bringing even the best names to the red and companies began to worry about the ways and means of servicing their massive debt. But there are some companies such as Essar Steel who felt a need to retire debt even before they were hit by the market conditions and thus pushed into the red.

Debt and Performance

There have a number of theories regarding the significance or the lack of it of debt in the capital structure of the firm. There have been extreme views ranging from a decided impact to those, which maintain that the existence or non-existence of debt has nothing to do with the valuation of a firm. Each view offers its own examples but the fact remains that the use of debt does have some impact on the profitability of the company. An empirical study on the correlation between debt and various other ratios of companies, which was conducted on a sample of 208 companies covering a span of eight years between 1978 to 1986 proves that there is correlation between the companies. The study indicates a strong negative correlation between the growth rate in EBIT and a firm's debt levels. The study further found that firms whose size is increasing are using a higher debt ratio.

The fact that the operating profit margins are higher for companies that have a lesser debt and hence, lesser interest outgo offers the necessary motivation for companies to attempt retiring debt once the need is managed. Moreover, prudence dictates that being indebted even in business is not exactly a good idea. Events such as the Asian Crisis have brought into light how heavy debt burden would bring down the financial system as a whole. The Korean Cheabols and many other industrial conglomerates across the Asian Economies had been under too much of a debt burden and servicing it became the real problem when they were in trouble. As an aftermath of the Asian Crisis, most of the affected countries have consciously put in place a number of debt restructuring measures. In order to speed up the process of debt restructuring, Malaysia set up a Corporate Debt Restructuring Committee (CDRC), which has been largely responsible for the restructuring of debt of a number of companies across the nation.

A Judicious Remedy

While lending monies has been a fairly stable practice with banks, the uncontrolled increase in NPAs has been a constant cause of concern. Banks and financial institutions that make their business to lend companies end up in trouble when companies are not in a position to honour their payment obligations. So a company in trouble or at the doorsteps is an ailing child of the banking system and through it of the whole country's economic system.

The South East-Asian Crisis brought into light the dangerous significance of the large amount of NPAs and the havoc they can play with the financial system of a country. As an aftermath of the crisis, most of the South-East Asian tigers put in place corporate debt restructuring mechanisms which are to look into the matter and try to address restructuring issues faster than the traditional methods, such as approaching the judiciary should make it possible. Notable among them is the measures implemented by Thailand and Malaysia. Thailand in particular has been successful in speedily bringing about debt restructuring in most of its corporates via the route of its Corporate Debt Restructuring Committee.

Internationally, it has been observed that the willingness of the creditors to co-operate in pulling out a company from the brink of bankruptcy is one of the major requirements for the successful implementation of debt restructuring measures. Their objective attitude in considering the pros and cons of each case individually and working with the intention to get back the company into shape rather than limiting the help to getting back their investments unscathed is a major help to companies trying to get back on their feet. This positive attitude and support from the creditors would go a long way in bringing companies back to shape.

No company would want to hold a more than necessary amount of debt on its balance sheets and at the first opportunity that crops up, companies that are conscious of their long-term health would be eager to retire their debt. In fact, some firms that have enough internal accruals are sitting on pile of cash that has been realised from the selling off some unrelated businesses such have only been too eager to repay their debt obligations, before they had actually become due.

'Debt', usually the one that has been taken during the boom period comes at higher rates of interest soon seems like the proverbial white elephant when the interest rates come down. The falling interest rate regime as the one now being witnessed in India gives companies an opportunity to retire high cost debt by replacing it with low cost debt.

Many Instances in India Inc

The falling interest rates have triggered debt restructuring, retiring high cost loans across Corporate India. A study conducted by one of the leading newspapers showed that 218 companies in the private corporate

sector retired secured and unsecured borrowings of Rs. 64.62 bn during the financial year 2000-01. During 2000-01, these firms repaid secured loans of Rs. 54.26 bn and unsecured loans of Rs. 10.36 bn, with most of the repayment being of bank loans (71.02). In addition, they also paid off Rs. 10.12 bn in loans from the financial institutions. Instead of relying on financial intermediaries, corporates are now directly raising funds in the market. During the year, these firms raised fresh resources of Rs. 16 bn through debentures.

Examples of companies in India Inc that have successfully implemented debt-restructuring measures are galore. Reliance Petroleum, which went into commercial production last year, reduced its debt by Rs 17.16 bn in 2000-01. During the year, the company refinanced high cost rupee debt of Rs. 38.90 bn to take advantage of the declining interest rate environment. It also refinanced Rs. 6.04 bn worth of foreign currency loans and repaid long-term loans of IDBI worth Rs. 9.61 bn. With the restructuring of loans, its debt burden was reduced by Rs. 24.62 bn. Reliance Industries reduced its debt burden by Rs. 13.84 bn. During the year, Reliance refinanced Rs. 8.80 bn of foreign currency syndicated loans, bought back Rs. 7.35 bn worth offshore bonds and exercised call options on domestic debt amounting to Rs. 20.89 bn. Grasim Industries, the Aditya Vikram Birla group company, reduced its debt profile by Rs.4.97 bn in 2000-01. The company reduced bank loans by Rs.2.01 bn, repaid debentures and long-term loans aggregating Rs.4.27 bn and raised low interest-bearing debentures worth Rs. 1.80 bn.

Steel Authority of India Ltd (SAIL)

The State-run Steel Authority of India Ltd. (SAIL) had undertaken huge amounts of debt totalling over Rs. 21000 crore as of April 1999. The company had undertaken such huge amounts of loans to fund its modernisation plans. However, the Government had embarked on an ambitious restructuring exercise to get the steel producer into shape. As a part of its debt restructuring, SAIL repaid its high cost debt (borrowed at interest levels of 15 per cent - 17 per cent) in bits and pieces for the last two years and had brought down its overall debt burden to Rs. 14200 crore as of 30th June, 2001. The company used a combination of the refinancing option and internal accruals to reduce debt. Since April 2000, the company has repaid an amount of Rs.2600 crore, out of which Rs.2100 was paid in the last fiscal while the remaining was repaid in the first quarter of the present financial year. The company was able to make the repayment of the debt from the internal accruals that resulted from the better operational efficiencies and tight fiscal management. In addition, SAIL raised fresh resources from the market to refinance a part of its high cost debt, to take the advantage of the lowered interest rate regime. It raised Rs.1400 crore in 2000-01 at an average interest rate of 12 per cent. In the recent quarter the firm raised yet another Rs. 293 crore at an average rate of 11 per cent. This debt restructuring and the resultant decrease in the interest burden is bound to have a positive impact on the bottom line of the company. This coupled with the other cost-cutting measures and the professional management of the business would bring in better times for the steel major.

ITC Bhadrachalam Ltd.

ITC Bhadrachalam, one of the significant players in the domestic paper industry was promoted by cigarette major ITC Ltd. With presence spawning across various segments of the paperboard manufacturing, the company has established itself as a major brand name in the Indian scenario. The company found itself in deep losses during 1998 owing to the downturn in the industry and its investment in expansion of its capacity. The higher interest outgo, lower per unit utilisation and the mounting costs of raw material and power were the main reasons for the company being in red. However, the company worked a turn around with the aid of its parent. The turn around included a major restructuring of the company's debt and increasing operations efficiency. This coupled with the rising international paper prices has brought the company back into shape.

One of the main reasons for the losses posted by the company has been the higher interest outgo. The company has prepaid its debts to the tune of Rs.260 crore by borrowing non-convertible debentures at the rate of 11.90 per cent and bridge loans at an average cost of 10.50 per cent. The parent company, ITC Ltd. has come to the rescue of its operations by contributing Rs.200 crore through the issue of preference shares. All these actions have resulted in a considerable reduction in the debt burden of the company and have also brought down the interest outgo from Rs.79.71 crore in 1999 to Rs. 45.98 crore thus, helping the company come back into a profitable shape. The company posted PAT of Rs. 34.89 crore as against a loss of Rs.32.12 crore last year.

Ashok Leyland Ltd.

One name that has been doing rounds in the commercial vehicles segment for all the right reasons is Ashok Leyland (AL). As against its long-standing competitor, Telco, the company has been in a better position, if not exactly churning out profits during the cyclical downturn that the industry is facing. AL is fast snatching the market share of Telco while keeping itself in above the water level. Strategic product mix, prudent debt management can be citied as two major contributing factors. The company has been cutting costs on all the fronts since 1998. As a part of this measure, the company has been repaying its high cost debt on one hand and reducing its inventory levels on the other. The company has used its free reserves to repay its high cost loans and also to buy-back shares with an aim to increase shareholders wealth in the long run. The company's interest outgo came down from Rs.169.57 crore for the year ending March 1997 to Rs. 132.16 crore by the end of March 2001. During the first half of 1999 -2000. Leyland retired Rs.190 crore of debt besides switching another Rs. 80 crore of loans into an interest rate range that is lesser by 2 - 2.5 per cent points less. This has led to the increase in the operating profit margins of the company with its PAT improving by 16 per cent in spite of a negligible fall in its sales figures. For the quarter ended June 2001, the company was in a position to successfully combat the slump in the Commercial Vehicle. On a negligible increase in sales figures from 6441 vehicles to 6446 vehicles,

Ashok Leyland posted an increase of 76.62 per cent increase in the operating margins at Rs. 346.62 mn from Rs196.25 mn in the same period last year. The interest outgo was lower at 202.05 mn as against 239.63 mn last fiscal. Net loss for the quarter has come down by 52.23 per cent, to Rs. 94.04 mn (Rs. 196.86 mn).

The largest developmental financial institution of India, Industrial Development Bank of India (IDBI) too has benefited from the debt restructuring that it has undertaken in the recent years. The performance of the company in the recent quarter stands as an example for the above fact. IDBI's interest income improved by 8 percent while its PAT surged by 82 per cent. IDBI's operating margins were more than 20 per cent for the first time in two years. The company had retired its high cost debt and has raised fresh funds at substantial lower interest rates in the year 2001 taking advantage of the lower interest rates. In 2001, IDBI repaid debt amounting to Rs. 39 bn and plans to pay back another 30 bn loans in the current year. This has led to a decline in the cost of rupee borrowing by IDBI, which has come down to 11.2 per cent from an erstwhile 12.4 per cent. In addition, the fact that IDBI has raised funds at rates of 4.8 per cent in FY01 and 5.2 per cent in FY00. To further take the advantage of the lower interest regime IDBI is planning to exercise the call option on its deep discount Flexibonds 1992 issue (interest rate of about 16.2 percent). The bond was originally issued for 25 years tenure, with a put and call option after every five years. IDBI could now raise fresh funds by about 500 basis points lower than the earlier 16 per cent debt.

Arvind Mills.

Arvind Mills is one case where the company has ended up in a mess riding high on the hope of good markets but albeit on borrowed money. Arvind Mills was one of the first companies to introduce branded apparel in the Indian markets as well for bringing in the now ubiquitous denim into the market. The company anticipated a huge surge in the market for denim and invested heavily in the necessary infrastructure to cater to the anticipated demand. By the end of the financial year 2000, Arvind Mills had a sum of Rs.1927.63 crore as its total borrowings and the interest outgo itself ranged to an amount of Rs. 282.02 crore. The company ended up in huge losses for the year owing to the decline in the demand as well as the heavy interest payments that it had to shell out. The consortium of 60-odd lenders who had advanced loans to the bank saw the trouble coming. The heavy debt burden and the plight of Arvind Mills have made it the most notorious example of an Indian company ending up in trouble owing to debt.

In a bid to reduce its debt mountain, Arvind Mills came up with a debt-restructuring package as per which the firm was to raise money through a rights issue that would be utilised to retire a portion of the debt. In addition, the package calls for the lenders to restructure the remaining portion of the debt totalling to around Rs.1250 crore, by extending the payment periods to 10 years beginning from 2005 (from the prevailing deadline which was 2004 in the case of most loans). The package also calls

for a reduction in the interest rates for these loans. The recast plan was designed in a way to reduce the debt burden and the interest cost for the firm and has been approved by the consortium of creditors. Thus, the firm had successfully restructured its debt obligations but to what extent this is going to boost the performance of the Arvind Mills specifically is profitability is yet to seen.

Essar Steel

Essar Steel, the first company that entered the steel sector, once private participation was allowed in the sector. It was the first company to set up 2 mn tonnes, state-of-the-art coast-based steel plant. The project was funded for a period of 7 years from the date of disbursement by the Indian Financial Institutions. 50 per cent of its debt was through foreign currency borrowings, which too were spread over a period of five years. But this period too was much less than internationally established standard of 12-15 years. However, the steel makers who entered the industry thereon were availing the loans with a maturity of 12 years from the date of disbursement. And by the time the other players entered the market, Essar Steel had 3-4 years left to repay the domestic debt and 2 years to repay the foreign loans. In spite of the fact that Essar Steel is one of the low cost steel producers it was not possible to repay the debt within such a short maturity. The company debt-equity ratio was at the levels of 4.46 in March 2000. The interest outgo from Essar Steel in FY 2000 was higher at Rs. 624.99 crore as against 488.08 crore the previous year. This contributed to the overall loss of the company, which too was higher at 581.24 crore as against a loss of 496.46 crores in spite of an increase in the company's sales figures. In order to resolve these issues and to avoid repeated liquidity crisis, improve interest coverage, the company went in for a restructuring of finances.

The company has successfully sought the approval of most of its creditors. The FRN holders agreed to extend the term of credit for a period of 5 years. The company then approached the domestic creditors with a request to extend the maturity period by another 8 years on par with the terms given to other steel producers. The company further negotiated a reduction in the interest rates too by getting the financial institutions led by IDBI to reduce it to 14 per cent from the earlier levels of 17 per cent-18 percent. It successfully negotiated with the other lenders too for an extension of the maturity by 5-6 years. The average interest rate for the company came down to 14 per cent from its erstwhile 17 per cent.

This would bring down a reduction of around Rs. 60 crores in terms of the interest costs. In order to improve things, Essar Steel has coupled its debt restructuring with restructuring of other areas of operations too such as the product profile, marketing and cutting down of costs. But the signs of recovery are not yet seen. All these measures seem to have little impact on the bottom line at Essar Steel, where things are far from good. The interest cost of company is yet to come down from its earlier levels. During the quarter ended June 2001, Essar Steel performance has been adversely affected by the slump in the steel market.

Using ADRs as Means to Retire Debt

One of India's top names in the Software Industry, Satyam Computers had at one point of time, heavy debt in its books. But the company has brought down its debt burden making a judicious use of the funds raised through its ADR or ADS issues. During the fiscal year 2001, the company reduced its debt burden from Rs. 29,132.51 lakh to Rs. 17,198.45 lakh. This resulted in a reduction in the interest outgo from Rs.40.68 crore to Rs. 34.52 crore. Continuing the efforts to reduce debt in the first quarter of 2001, the company retired Rs.146 crore debt thus, reducing its overall debt burden to Rs.26 crore. Interest charge for the current quarter at Rs. 8.2 crore includes prepayment penalty of Rs. 3.41 crore.

Debt is like the necessary evil that turns into a mortal danger when the markets are in a downturn. Many companies have attempted debt restructuring but only some have been able to time it properly enough to reap positive outcome and these are those companies who have seen the trouble coming and have sought to find remedies ahead of time.

RBI, Waking up

The Indian Government and the RBI too taking heed of the increasing malice of NPAs, have sought to establish a corporate debt restructuring system in place. This system would be working outside the purview of either the BIFR (Board for Industrial and Financial Reconstruction) or the DRT (Debt Recovery Tribunal). Thus, this measure can be utilised before the company is actually declared a sick unit or before the loan account is declared an NPA. Putting such a measure into practice, the RBI has established a corporate restructuring committee which is to look into the loans lent by multiple banks, syndication or through consortium accounts and where the limit is 20 crore and above. Standard and sub-standard accounts are to be considered for corporate debt restructuring. Loans that are on the verge of becoming NPAs have to be given the highest priority. The CDR system would be a voluntary mechanism to be entered into by lenders and debtors. However, the restructuring exercise would become binding on all parties once 75 per cent of secured creditors by value agree on a debt restructuring plan for an ailing corporate. The CDR system would operate under the regulatory powers of the RBI, which would issue guidelines and instructions as and when required. How successfully this measure will be implemented and how companies will use such a facility would be something only time can tell but the move itself is an indication of an uncommon pro-active stance taken by RBI with regard to restructuring of debt.

Multiple Choice Questions:

(1) In diligence questions particularly address issues such as:

(a) Ethical policies (b) Employment

(c) Management (d) Commercial sale

(e) All of above

(2) Both the parties to the transaction should conduct their own due diligence to get accurate assessment of potential

(a) Risks (b) Rewards

(c) Both (i) and (ii) (d) Either (i) or (ii)

(e) None of above

(3) The due diligence exercise is carried out by a team of executives from the acquirer include:

(a) Investment Bankers (b) Solicitor

(c) Chartered Accountant (d) All of above

(e) None of above.

(4) Whether the buyer has the financial resources to finance the agreed purchase price is the main objective of

(a) Due Diligence (b) Buyers Due Diligence

(c) Seller's due diligence (d) All of above

e) None of above.

(5) Good ethics and governance strengthen brand equity and help endure

(a) Stable growth (b) Sustainable growth

(c) Negative growth (d) All of above

(e) None of above.

(6) Corporate Governance is facilitated by the establishment of a system whereby directors are entrusted with responsibilities and duties in relation to the stewardship of a

(a) Country's affairs (b) Company's affairs

(c) Management's affairs (d) Employer's affairs

(e) None of above.

Theory Questions.

(1) Explain the concept of Due Diligence.

(2) Explain "Structuring the Deal" concept in context with Buyer's Due Diligence and Sellers Due Diligence.

(3) How corporate governance issues affects M&A? Explain.

(4) Discuss different governance issue in merger interaction.

(5) How M&A creates shareholders value? Explain.

(6) Describe governance issues in Takeover Defenses.

(7) How can M&A lead to governance failure.

(8) How can we assess country governance practices.

(9) Explain the theory of a multinational enterprise.

(10) What are the motives behinds international M&A.

(11) Why are international M&A's failing in India.

(12) Distinguish between buyers and sellers due diligence.