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Internal Assesment Test - I

Sub:	Mergers Acquisitions and Corporate Restructuring							Code:	17MBAFM401
Date:	18.03.2019	Duration:	90 mins	Max Marks:	40	Sem:	II	Branch:	MBA

	Marks	OBE CO	OBE RBT
Part A - Answer Any Two Full Questions (16*02=32 Marks)			
1 (a) Define merger	[02]	CO1	L1
(b) Explain the role of industry life cycle in merger	[06]	CO1	L4
(c) **Theories of mergers**	[08]	CO1	L2

1 (a) Define merger [02] CO1 L1

A merger is the combination of two companies into one by either closing the old entities into one new entity or by one company absorbing the other. In other words, two or more companies are consolidated into one company.

(b) Explain the role of industry life cycle in merger [06] CO1 L4

- **Pioneering Phase**: start-up founders may opt to "cash out" of their promising ventures by selling to larger companies that are seeking growth opportunities. Horizontal and conglomerate mergers.
- **Accelerating Growth Phase**: highly profitable and fast growing companies in new industries may sell themselves to more established companies in order to access capital for business expansion. Horizontal and conglomerate mergers.
- **Mature Growth Phase**: larger companies with slowing growth rates may look for targets with value potential or targets that can facilitate economies of scale. Horizontal and vertical mergers.
- **Industry Maturity Phase**: an acquiring company is now growing around the same pace as that of the economy; it will look for targets that can increase economies of scale or invest in small growing concerns that provide return opportunities for shareholders. Horizontal mergers.
- **Decline Phase**: overall industry is shrinking; an acquirer may look for synergies, to buy profitability of younger firms, or to simply survive. Horizontal, conglomerate, and/or vertical mergers.

(c) **Theories of mergers** [08] CO1 L2

1. **Differential Efficiency**
   The differential efficiency explanation can be formulated more vigorously and may be called a managerial synergy hypothesis. If a firm has an efficient management team whose capacity is in excess of its current managerial input demand, the firm may be able to utilize the extra managerial resources by acquiring a firm that is inefficiently managed due to shortage of such resources.
   For example, if the management of firm A is more efficient than the management of firm B and if after firm A acquires firm B, the

efficiency of firm B is brought up to the level of efficiency of firm A, efficiency is increased by merger. The level of efficiency in the economy would be raised by such mergers.

2**. Inefficient Management**

• Inefficient management is simply not performing up to its potential. Another control group might be able to manage the assets of this area of activity more effectively.

• Inefficient management theory could be a basis even for mergers between firms with unrelated businesses.

3.Pure Diversification

• First, in contrast to the position of shareholders who can diversify across firms in the capital market, employees of the firm have only a limited opportunity to diversify their labor sources. Diversification of the firm can provide managers and other employees with job security and opportunities for promotion and, other things being equal, results in lower labor costs.

Undervaluation

• Some studies attribute merger motives to the undervaluation of target companies. One cause of undervaluation may be that management is not operating the company up to its potential.

2 (a) **Distinguish Mergers from acquisitions.** [02] CO1 L2

Key difference: When one company takes over another and clearly establishes itself as the new owner of the company, the purchase is called an acquisition. A 'merger' happens when two firms, often about the same size, agree to operate and go forward as a single company, are said to merge together.

Mergers and acquisitions happen when companies merge with other companies creating a bigger business or to buy another business/company. Businesses do this as a mean to gain a competitive advantage over their competitors. The difference lies in how the purchase is communicated to and received by the target company's board of directors, employees and shareholders. Although they are often used as though they were synonymous, the terms merger and acquisition are slightly different.

(b) Write a note on BCG matrix in reference with M & A [06] CO1 L1

BCG Matrix GE Matrix SWOT Analysis Strength of mergers and acquisitions Weakness of mergers and acquisitions Opportunities for mergers and acquisitions Threats of mergers and acquisitions Porter s Five Forces Module

3 Bruce Henderson of the Boston Consulting Group developed in 1970, a portfolio planning model and called it the BCG Matrix. This is to help companies analyze their business units or product lines. A company s units are classified into four categories based on the combinations of market growth and market share relative to the largest competitor.

4 Market growth serves a proxy for industry attractiveness and relative market share serves as a proxy for competitive advantage. The matrix aims to map the business unit s position within these two important profitability determinants. When the market growth and market share are divided into two parts, a 2X 2 matrix emerges. The cells are used to classify the business into categoriescash cows, dogs, question marks and stars.

5 Cash cows- Are units with market share in a slowgrowing industry. These units typically generate cash in excess of the amount of cash needed to maintain the business. They are regarded as staid and boring, in a mature market, and every corporation would be thrilled to own as many as possible. Dogs- Dogs or more charitably called pets, are units which low market share in a mature, slow growing industry. These units typically break even, generating barely enough cash to maintain the business market share.

6 Question marks- question mark (also known as problem child) are growing rapidly and thus consume large amounts of cash, but because they have low market shares they do not generate much cash. A question mark has the potential to gain market share and become a star, and eventually a cash cow when the market growth slows. If the question mark does not succeed in becoming the market leader, then after perhaps years of cash consumption it will degenerate into a dog when the market growth declines.

7 Stars- Stars are units with a high market share in a fast growing industry. The hope is that stars become next cash cow. Sustaining the business unit s market leadership may require extra cash, but this is worthwhile if that s what it takes for the unit to remain a leader.

(c) Explain the motives behind mergers and acquisition [08] CO1 L4

Motives of Mergers

- Procurement of Supplies
- Market Expansion
- Financial Strength
- Diversification
- Taxation Benefits
- Managerial Motives
- Acquisitions of specific Assets
- Growth Advantage

Revamping Production Facilities

1. **Procurement of Supplies**
   - ✓ To safeguard the source of supplies of raw materials or intermediary products.
   - ✓ To obtain economies of scale of purchase in the form of discount, saving in transportation costs, overhead cost in buying

department, etc.

- ✓ To share the benefits of supplies economies by standardizing the material

2. **Market expansion & strategy**
   - ✓ To eliminate competition & protect existing market.
   - ✓ To obtain new market outlets in possession of the offeree.
   - ✓ To obtain new product for diversification or substitution of existing products & to enhance the product range.
   - ✓ Strengthening retail outlets & sales depots to rationalize distribution.
   - ✓ To reduce advertising cost & improve public image of the offeree company
3. **Financial Strength**
   - ✓ To improve liquidity & have direct access to cash resource
   - ✓ To dispose of surplus & outdated assets for cash out of combined enterprise.
   - ✓ To avail tax benefits.
   - ✓ To improve EPS

4. **Diversification**

Mergers and acquisitions are motivated with objective to diversify the activities so as to avoid putting all the eggs in one basket & obtain advantage of joining the resource for enhanced debt financing & better serviceability to shareholders. Such amalgamations result in creating conglomerate undertakings.

5**. Taxation benefits**

Mergers take place to have benefits of tax laws &company having accumulated losses merge with profit earning company that will shield the income from taxation. Section 72 A of I.T act 1961 provides this incentive from reverse mergers for the survival of sick units.

6. Managerial motives:

Managers benefit in rank, status and perquisites as the enterprise grows and expands because their salaries, perquisites & status often increase with the size of the enterprise. The acquirer may motivate managerial support by assuring benefits of larger size of the company to the managerial staff.

7. Acquisition of specific assets

Surviving company may purchase only the assets of the other company in merger. Sometimes vertical mergers are done with the motive to secure source of raw material but acquiree rather than acquiring the whole undertaking with assets and liabilities.

8. Growth Advantage

Mergers & Acquisitions are motivated with a view to sustain growth or to acquire growth. To develop new areas becomes costly, risky & difficult than to acquire a company in a growth sector even though the acquisition is on premium rather than investing in new assets or new establishments.

9. Revamping production facilities

 To achieve economies of scale by amalgamating production facilities through more intensive utilization of plant & resources.

 To standardize product specifications, improvement of quality of product, expanding market & aiming at customer satisfaction.

 To obtain improved production technology & know how from the offeree company to reduce cost, improve quality & produce competitive products to retain & improve market share

3 (a)	**What do you mean by synergy** Synergy: Concept Synergy refers to a situation where the combined value of a firm is more than the sum of the values of individual firms. It is a phenomenon where 2 +2 = 5 If the value of the firm A is VA, value of firm B is VB and Combined value of the firm is VAB Value of the combined firm = Value of firm A + Value of firm B + Value of synergy VAB' = VA+ VB + VAB , is the value of synergy or VAB ' = VAB – (VA+ VB	[02]	CO3	L1
(b)	**Explain in detail the forms of merger and its types**	[06]	CO1	L4

Types of merger

1. Horizontal Mergers
2. Vertical Mergers
3. Conglomerate Mergers
4. Concentric Mergers
5. Circular Combination

Horizontal Merger

This involves two firms operating in the same kind of business activity. Both acquiring and the target company belong to same industry.

Main purpose is to obtain economies of scale in production by eliminating duplication of facilities and operations.

This is a combination of two or more firms in similar type of production, distribution or area of business.

Vertical Merger

This occurs between firms in different stages of production and operation.

Expands the espousing backward integration to assimilate sources of supply and forward integration towards market outlets.

Vertical merger occurs when a firm acquires firms ‘Upstream’ from it or firms ‘downstream’ from it.

In case of an ‘**Upstream’ merger** it extends to the firms supplying raw materials and to those firms that sell eventually to the consumer in the event of a ‘down-stream’ merger.

When co combines with the supplier of materials it is called **backward merger** and when it combines with the customer it is known forward merger

Conglomerate Merger

This occurs between companies engaged into two unrelated industries.

Conglomerate merger represents a merger of firms engaged in unrelated lines of business.
Rationale for such merger: Diversification of risk

Concentric Mergers: A merger in which there is carry –over in specific management functions (ex: marketing) or complementarily in relative strengths among specific management functions rather than carry-over/complementarities in only generic management functions (eg: planning).

(c) **Describe Porter's five force model** [08] CO1 L

BCG matrix : Bosting Consulting Group Matrix

Introduction

The business portfolio is the collection of businesses and products that make up the company. The best business portfolio is one that fits the company's strengths and helps exploit the most attractive opportunities.

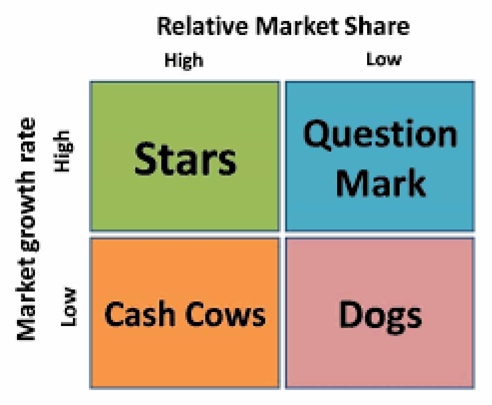
The company must:

(1) Analyse its current business portfolio and decide which businesses should receive more or less investment, and

(2) Develop growth strategies for adding new products and businesses to the portfolio, whilst at the same time deciding when products and businesses should no longer be retained.

Methods of Portfolio Planning

The two best-known portfolio planning methods are from the Boston Consulting Group (the subject of this revision note) and by General Electric/Shell. In each method, the first step is to identify the various Strategic Business Units ("SBU's") in a company portfolio. An SBU is a unit of the company that has a separate mission and objectives and that can be planned independently from the other businesses. An SBU can be a company division, a product line or even individual brands - it all depends on how the company is organised.



Using the BCG Box (an example is illustrated above) a company classifies all its SBU's according to two dimensions:

On the horizontal axis: relative market share - this serves as a measure of SBU strength in the market

On the vertical axis: market growth rate - this provides a measure of market attractiveness

By dividing the matrix into four areas, four types of SBU can be distinguished:

Stars - Stars are high growth businesses or products competing in markets where they are relatively strong compared with the competition. Often they need heavy investment to sustain their growth. Eventually their growth will slow and, assuming they maintain their relative market share, will become cash cows.

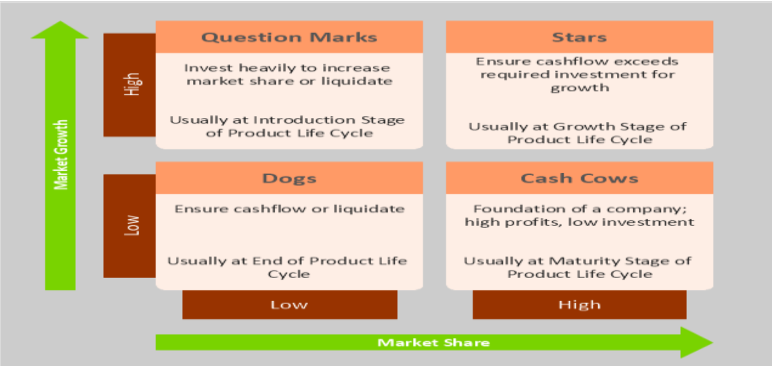
Cash Cows - Cash cows are low-growth businesses or products with a relatively high market share. These are mature, successful businesses with relatively little need for investment. They need to be managed for continued profit - so that they continue to generate the strong cash flows that the company needs for its Stars.

Question marks - Question marks are businesses or products with low market share but which operate in higher growth markets. This suggests that they have potential, but may require substantial investment in order to grow market share at the expense of more powerful competitors. Management have to think hard about "question marks" - which ones should they invest in? Which ones should they allow to fail or shrink?

Dogs - Unsurprisingly, the term "dogs" refers to businesses or products that have low relative share in unattractive, low-growth markets. Dogs may generate enough cash to break-even, but they are rarely, if ever, worth investing in.

Using the BCG Box to determine strategy

Once a company has classified its SBU's, it must decide what to do with them. In the diagram above, the company has one large cash cow (the size of the circle is proportional to the SBU's sales), a large dog and two, smaller stars and question marks.



Part B - Compulsory (01*08=08 marks)

4

(a) What is demerger and explain its types [04] CO1 L4

Definition: Demerger is the business strategy wherein company transfers one or more of its business undertakings to another company. In other words, when a company splits off its existing business activities into several components, with the intent to form a new company that operates on its own or sell or dissolve the unit so separated, is called a demerger.

Spin-off: It is the divestiture strategy wherein the company’s division or undertaking is separated as an independent company. Once the undertakings are spun-off, both the parent company and the resulting company act as a separate corporate entities.

Split-up: A business strategy wherein a company splits-up into one or more independent companies, such that the parent company ceases to exist. Once the company is split into separate entities, the shares of the parent company is exchanged for the shares in the new company and are distributed in the same proportion as held in the original company, depending on the situation.

(b) From the following details calculate cost of merger, and the net gains on merger [04] CO3 L3

Firm X is having a value of Rs 450 Crores and Firm Y is having a value of Rs

250 crores. If 2 firms combine the estimated cost savings is estimated to be Rs 75 crores. Firm X agrees to make payment to Firm Y equals to Rs 200 Crores while making the acquisition.

Course Outcomes		PO1	PO2	PO3	PO4	PO5	PO6	PO7
CO1:	Understand Corporate and merger acquisition activity	1a,c 2c	2a			1b, 3b, 3c	2b	
CO2:	Analyse M & A deals that took place in the past							
CO3:	Understand the synergies of M &A	3a						
CO4:	Compute the valuation associated with M & A							
CO5:	Understand the human and cultural aspect of M &A							

Cognitive level	KEYWORDS
L1	List, define, tell, describe, identify, show, label, collect, examine, tabulate, quote, name, who, when, where, etc.
L2	summarize, describe, interpret, contrast, predict, associate, distinguish, estimate, differentiate, discuss, extend
L3	Apply, demonstrate, calculate, complete, illustrate, show, solve, examine, modify, relate, change, classify, experiment, discover.
L4	Analyze, separate, order, explain, connect, classify, arrange, divide, compare, select, explain, infer.
L5	Assess, decide, rank, grade, test, measure, recommend, convince, select, judge, explain, discriminate, support, conclude, compare, summarize.

PO1 - *Knowledge application; PO2 - Analytical and logical thinking; PO3 - Team work; PO4 - Leadership; PO5 - life-long learning; PO6 - Analyze and practice aspects of business;* PO7- *Personal and Societal growth*;