THE BOTTOM LINE

Mergers and Acquisitions

FORWARD

Dear Readers,

We wish you a very happy and healthy new year!

We are excited to present the fifth edition of 'The Bottomline', a joint initiative of Beta at IIM Ahmedabad, Networth at IIM Bangalore, Finance and Investment Club at IIM Calcutta and Credence Capital at IIM Lucknow.

The first edition of 2021 will explore the theme of 'Mergers and Acquisitions' through articles contributed by students and industry experts. 2020 was a roller coaster year for mergers and acquisitions. Deal makers notoriously hate uncertainty, the thing Coronavirus has in spades. However, the disruption caused by the pandemic and the weakened finances of many companies is expected to result in a spurt in consolidations, mergers and acquisitions.

The pandemic has been a boon for Tech firms the world over. Increased digital consumption has led to soaring interest in tech-based investments. No wonder, then, that India witnessed a 62% YoY increase in the M&A deals in 2020 in the Technology, Media and Telecom (TMT) sector. Online Grocery is another segment to watch out for. Bigshots such as Reliance Retail, Tata Group etc. are keen on acquiring the e-grocers and expand their retail presence. While the strategic M&A in the other sectors remain more or less flat, PE-backed mergers and acquisitions saw a meaningful decline, as traditionally, they are active in the hospitality, tourism and travel, industries that were worst hit by the pandemic.

In this edition, we will throw some light on the M&A strategies that are expected to be prevalent post-covid as companies position themselves for improved economic activity and reframe their future. M&A recovery that began in the second half of 2020 is expected to accelerate in 2021. The targets will come from a growing pool of sellers – businesses that have fallen into distress during the recession, PEs that always think of holding periods and exits. Additionally, the recent rise of Special Purpose Acquisition Companies (SPACs) as favorable alternatives to restructuring is also likely to continue.

The Covid-19 pandemic has changed how we work, redefining the standard business practices. Video conferencing is now the norm, replacing local in-person meetings. Beyond remote communication technology, the pandemic has highlighted the need for tools that allow deal makers to successfully manage M&A processes – no matter their location. Still, there are a variety of economic, governmental, and medical factors that will dictate the activity of the 2021 M&A market.

P.S. – Any feedback from our readers, be it topics addressed, quality of content, potential topics, etc. would be welcome. We hope that every subsequent issue is better than the last.

Happy Reading!!

Indian Economic Outlook post Covid'19

Economies across the globe have felt the brunt of the pandemic, the severity of the blow to the Indian Economy is showcased by the contracted economic output, investment & exports, and private consumption expenditure and consumer confidence. The GDP declined by 23.9% in Q1FY'21, private consumption expenditure reduced by 26.7%, which can be attributed to supply-chain disruptions, halt in operation, factory closures, soaring unemployment due to Covid'19 and consequently a dip in capacity utilization which led to a decline in gross fixed capital formation by ~47%. At the global level, the export demand reduced by 19.8% and the imported declined by ~40% due to decline in oil prices. The stimulate the economy, and cover the decline in private expenditure the government expenditure rose by 16.4%. It is hard to comment, whether the generous package can break the panic driven viscous cycle of low demand and ex post investments. The Business Confidence Index and Consumer Confidence Index, reflect low confidence and fear among the productive deficit spenders as well as the surplus household savers.

Shifting gears towards the industry side, the GVA reduced by 22.9% in Q1FY'21. All the sectors were hit due to the lockdown except the necessities including the agriculture, fishery and forestry sector. The manufacturing sector growth dropped by ~39% and manufacturing dropped by ~50% while the service sector plunged by 20.6%. The 3.4% exceptional growth in the agricultural sector is attributable to the good monsoon, migrant workers returning to their farms. The output contraction within the service and the tertiary sector is also very skewed, the trade, hospitality, travel, tourism and leisure, communication & services was knocked hardest and it plunged by ~47%.

While the trade and communication services have made their way through the pandemic and are steadily recovering, the travel tourism and the hospitality sector shows bleak signs of recovery. The NBFC, banking, real estate and professional services sector contracted by 5%, due to spill over effects of the subdued demand, credit outflow and supply side shocks, hence adding stress on the financial sector. The supply chain disruption, panic driven hoarding, dovish monetary stance, labour shortage lead to soaring WPI primarily driven by rising warehousing and logistic costs. The retail inflation post Covid'19 has been ~7%, The core inflation was as high as 5.57%-5.95%, the actual retail inflation for the month of November was 6.93%, down 67 basis points from 7.6% in the month of October, hence showing signs of convergence to targeted 2%-6% range.

The anxiety of soaring unemployment,

safety norms, health will significantly change consumer behaviour, expectations and hence the business models and best practices across industries. While the supply chain bottlenecks and structural constrains are easing, a major concern would be financial health of the economy. On the path of recovery, debt ridden MSME's, small and medium entrepreneurs would require more credit to continue operations, on the other hand NPA laden banks would not have the cushion to finance these subprime borrowers, hence even if the demand recovers writing off losses, building consumer/business confidence and dealing with the twin balance sheet problem is essential for smooth monetary transmission and effective fiscal stimulus. Other major concern is the rising public debt (huge fiscal package of 10% of GDP given) , quantitative easing, low repo, LTRO's, operational twist which could lead to inflationary pressure if the monetary transmission is not complete. Thriving the pandemic brunt would require boosting consumer confidence, robust structural measures in the financial and health care sector, land acquisition and labor challenges induced due to pandemic must be taken care of, investor resilience and innovative business models to gain consumer trust. In the long term, the focus should be on reducing infrastructural constrains and structural bottlenecks to increase ease of doing business and reducing the cost of doing business.

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ARTICLES

M&A strategies in post-pandemic era 1
Anik R. Koria

Decoding the Leveraged Buyouts 6
Bhadrik Gosar

The return of a hostile world - Common strategies against hostile takeovers 9
Ashwath Vohra

A perspective on successful and unsuccessful M&A transactions 11
K. M. Tejkiran

Bigshots eye on e-grocers 14
Godavarthi Srikanth

Start-up acquisitions in India 16
Udhav Khana

SPAC: Is it a fad or a long-term shift? 19
Ashish Goel

Is allowing Indian corporates/industrial houses to open banks a good idea? 22
Pratik Gandhi

Is India a currency manipulator? 25
Finshots

M&A STRATEGIES IN POST-PANDEMIC ERA

I. Introduction

Globally, M&As have existed since 19th century. Over a century, M&A tides surged during economic boom driven by innovations, deregulation, privatisation, political stability, favourable laws, etc. and receded during economic turmoil driven by wars, market crash, oil crises, pandemic, etc. Each tide achieved different outcomes such as globalisation, consolidation, diversification, building conglomerate, etc.

Today, Covid-19 has disrupted global economy. Traditional sectors such as manufacturing, logistics, hospitality, travel, real estate, etc. are bleeding. However, new-age technology driven sectors have seen growth. As per October-2020 IMF estimates, GDP growth forecasts are:

Region	2020	2021	2021-25 Average
Global	c.-4.4%	c.5.2%	c.4.1%
India	c.-10.3%	c.8.8%	c.7.8%

During pandemic most investors have taken wait and watch approach, thus impacting overall M&A activities with some exceptions. Let's discuss some of the traditional M&A strategies which would be prevalent in post-pandemic era.

II. M&A strategies expected to be prevalent post-Covid

While M&A activity has slowed during pandemic, it is expected to be back on track post-pandemic due to emergence of new opportunities and challenges. Some of the key strategies which would drive M&A post-Covidare:

1. <u>Consolidation:</u>

This has been one of the biggest drivers of M&A globally. It means industry leaders combine with less competitive players to rationalise industry capacity, gain market share, achieve portfolio coherence, increase operational efficiency and enhance innovation to regain competitive advantage.

<u>Example:</u> Bayer acquired Monsanto for US$66bn in 2018 at a premium of c.45% to trading share price. Bayer felt the compulsion to acquire Monsanto post two large consolidations in global agriculture market in 2015-17: (a) Chem China acquired Syngenta for c.US $43 bn and (b) c.US $130 bn merger of Dow Chemical with Dupont. Bayer-Monsantonow has an integrated agriculture business with broad product portfolio and strong R&D capabilities. It got first mover advantage to create the biggest platform to control the global food value chain in terms of pesticides to be used and seeds to be planted.

Pandemic has led to significant demand destruction and inefficiencies across sectors. This has created opportunities to consolidate through M&A. Therefore, consolidation will continue to be one of the biggest drivers of M&A in post-Covid era.

2. Product or market extension:

This means extension of a company's product line or market reach. These are win-win propositions. For acquirer the deal provides entry into a new geography or product line and for target it means access to capital, marketing capabilities and modern technology. Success depends on the ability to grow on each other's strengths, market leadership and best practices.

Example: Joint venture between RIL and BP in fuels and advanced mobility space has enabled BP to enter India. Joint venture will leverage joint branding, RIL's pan-India leadership, and BP's global experience in differentiated fuels and advanced mobility solutions.

Several manufacturers are planning to shift from China to India. M&A with Indian entities would enable global players to quickly enter India and shift supply chains without causing severe disruptions to their global operations.

3. Survival:

At times survival may be at stake due to changes in technology, market preferences and laws, improved efficiency and effectiveness of competitors, losing market share, etc. Therefore, in order to gain competitive parity and ensure survival, an entity may engage in M&A even if it may not generate economic returns.

Example: Facebook acquired WhatsApp for US$16bn to stay relevant in the social media space. Walmart acquired Flipkart for US$16bn to achieve competitive parity with Amazon. In both cases acquirers have not reaped returns but deals ensured their global relevance and survival.

Covid-19 has affected several large players inmanufacturing, hospitality, travel, logistics, and real estate sectors. To ensure continued survival, large players with strong balance sheet would be scouting for stressed targets to regain market share and competitiveness.

4. Industry convergency:

This means evolution of new industry and business model by combining resources from existing industries with disappearing boundaries. With going digital as the new theme across sectors, this strategy has already gained prevalence. As per NASSCOM, technology spending during pandemic has significantly increased with 30% jump in digital transformation deals and 80% jump in cloud spending.

<u>Example:</u> Over last 5 years Jio has converged from a pure play telecom operator to a technology enable digital services company. Driven by this convergence, Jio completed a one of its kind fundraise of c.US$20bn, despite economic downturn, from strategic investors such as Facebook and Google, and several global marquee financial investors who have similar focus.

5. <u>Deploying free cash flow:</u>

Several firms which generate high cash flows have two alternatives: (a) to distribute dividend or buy back shares, (b) to reinvest in opportunities which would generate high returns for shareholders. In the latter, entities deploy M&A strategy to continue to create value for shareholders.

<u>Example:</u> LVMH share price has tripled in last four years driven by deployment of its excess free cash flows to acquire Christian Dior's Couture Brand and Bel mond in 2017-2018 and Hermes, Bulgari and Loro Piana during 2010-2016.

While all M&A activities aim to create shareholder value, they represent different strategies. In the post-Covid era, it would be important to objectively evaluate the rationale of proposed M&A to ensure that the focus on strategic objectives is not lost and investors do not suffer any loss of value due to either loss of competitiveness or reckless management decisions.

II. <u>Due Diligence ("DD")</u>

Deal making is glamorous, however M&A team is equally responsible to suggest a no-go in case the proposed deal does not fit overall strategy. Initial high-level discussions in buy side M&A transactions focus largely on financial models, valuations and public profile. However, key to success is thorough high-quality objective DD to evaluate the business case in entirety including assumptions and logic, evaluate synergies, determine value on as-is basis, identify risks and liabilities and determine price gap. DD is a science as well as an art – combines backward looking findings with forward looking strategy.

Given pandemic has led to significant disruptions across sectors, importance of DD in the post-pandemic era has only increased. An effective DD would equip management with effective tools to make right go-no-go decisionstocreate or safeguard shareholder value.

III. <u>Key risk mitigation measures</u>

Once decided to go ahead, legal documentation is critical to complete the deal. Several transaction issues, such as valuation gap, price adjustments, and indemnities, which have upfront monetary bearing for both parties, get resolved only through documentation. Both parties try to mitigate the economic

risks by deploying following key measures:

1. **Earnouts:**

In this, total consideration is broken down in to two parts: (a) Upfront consideration, (b) Earnouts, i.e. deferred / contingent consideration. Payment of earnouts is dependent on achieving certain milestones related to growth, earnings, synergies, approvals, etc. over a definite period. Larger the valuation gap or uncertainties, higher the earnout component.

Example: In 2019, Saudi Aramco announced purchase of 70% stake in SABIC from PIF for c.US$69 bn. Consideration structure is heavy on earnout component due to high growth and synergy estimates coupled with fall in global crude prices and petrochemicals margins which increased uncertainties.

Evolution of earnout structure	Upfront (%)	Earnout (%)
Initial agreement in March-2019	50%	50% up to . December-2021
Amendment 1 in October-2019	36%	64% up to September-2025
Amendment 2 in June-2020	c.10%	c.90% up to April-2028

While agreeing terms of earnout, long-term performance should not be compromised to achieve short-term results.

2. **Warranties and indemnities:**

Buyers ask for several warranties from sellers to hold them accountable for the disclosures during due diligence. In case of breach of warranties sellers are liable to indemnify buyers subject to a de-minimis, basket and cap over a definite period. Creating a balance through negotiations is a science as well as an art.

Post-pandemic, buyers would seek Covid-19 specific warranties and higher indemnities to cover business, financeand disclosure risks. Sellers may mitigate this risk by availing Warranty and Indemnity Insurance.

3. **Material adverse event ("MAE"):**

MAE provides the parties with walk away rights in certain events which lead to a material long-term change after signing. Such events include change of laws, significant changes in the industry / business / assets, insolvency, etc.

Post-pandemic, buyers would insist on including events linked to Covid-19. Sellers would insist on including only specific and quantifiable events. Therefore, tough negotiations would be required to create a balance.

Covid-19 has only increased the M&A risks. Therefore, importance of risk mitigation through legal documentation has significantly increased for both parties. Otherwise, the parties would walk away from the deal even if positive synergies are expected.

IV. Conclusion

To counter Covid-19 driven economic downturn, globally governments have introduced several policy initiatives. Initiatives such as "Make-in-India", "Atma Nirbhar Bharat", changes in FDI and other laws, and tax concessions have made India a hot destination for global investments attracting FDI inflows of c.US $40 bn during 6mFY2020-21.

With V-shaped economic recovery and strengthened fundamentals, M&A transactions would increase multi-fold.Above discussed time-tested traditional M&A strategies coupled with new learnings from pandemic would strongly come into play to successfully execute M&A transactions, create value for the shareholders and establish new economic order.

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Will maturing distressed assets space lead to a rise in Leveraged Buyouts in the M&A market in India? - Decoding the Leveraged Buyouts

Abstract:

We all would be familiar with famous M&A deals where Indian companies acquired global companies like Tata Tea's acquisition of Tetley (UK), Tata Steel's acquisition of Corus (UK), UB Group's acquisition of Whyte & Mackay (UK), Suzlon Energy's acquisition of Hansen Transmission (Netherlands). But did you know that these deals have something in common? The mode for these deals was Leveraged Buyouts (LBO).

India has emerged as one of the strongest markets for Mergers and Acquisitions (M&A). As per the 2019 report of Deloitte India, the value of M&A activity was USD 129 billion and USD 64 billion, respectively in 2018 and 2019. The year 2019 witnessed an increase of 13.8% in investments by Private Equity players in terms of value. However, a notable trend is that the use of debt as a mode to fund these acquisitions has increased.

Target Company	Country	Indian Acquirer	Value	Type
Tetley	United Kingdom	Tata Tea	271 million	LBO
Whyte & Mackay	United Kingdom	UB Group	550 million	LBO
Corus	United Kingdom	Tata Steel	11.3 billion	LBO
Hansen Transmissions	Netherlands	Suzlon Energy	465o million	LBO
American Axle1	United States	Tata Motors	2 billion	LBO
Lombardini+2	Italy	Zoom Auto Ancillaries	225 million	LBO

[1]Potential Aid [2]Buyout attempt

A recent Bloomberg report in December 2019 highlighted a spike in LBO deals. According to this report, foreign currency syndicated LBO loan volumes involving deals in India has jumped to USD 891 mn. Some of the notable transactions involve Barging Private Equity signing USD 360 mn LBO loan facility to back its purchase of a stake in NIIT Technologies and Blackstone group signing USD 166 mn LBO loan facility for financing its acquisition of Essel Propack Ltd.With an increase in LBO transactions, let's try to decode LBO as a transaction.

What is a Leveraged Buyout?

It is a process of acquiring a target firm in which the acquiring company buys the shares of the other company through a combination of equity and borrowed funds. A leveraged buyout is a type of buyout when the acquiring company raises funds for acquiring the other company largely through debt. The financial sponsor raises debt by issuing bonds or securing a loan which is secured by the assets of the acquisition target or for that matter the cash flow of the target

to make the timely payment of interest and principal amount.

Key aspects in a LBO transaction:

- **Key advantages in a LBO transaction:**
  - o The purchase is debt-driven. It gives you the benefit of tax advantages due to interest payouts.
  - o Better returns compared to a whole equity funding transaction.
- **Key disadvantages in a LBO transaction:**
  - o High dependence on the cash flows of the target for the success of the transaction and repayment of debt.
  - o Can lead to the bankruptcy of the target
- **Key considerations in a LBO:** Industry characteristics, company-specific characteristics, and market conditions play a pivotal role. Target backed by assets having a competitive advantage in an industry that gives an assurance on the cash flows and having a market dominance is good targets for a LBO transaction.
- **Key credit metrics to be evaluated while investing through the LBO model:** Apart from the industry specific operational parameters and financial parameters, some of the key credit ratios to be evaluated in a LBO transaction involve Debt/EBITDA, Interest Coverage, Debt service coverage ratios.
- **Capital structures in the LBO model:** LBO capital structures may include components of bank debt, high yield/subordinate debts, mezzanine debts along with equity.

Regulatory hurdles to an inbound LBO: Various restrictions levied on banks through RBI circulars, on companies through Companies Act and other regulatory measures, LBO structures face hurdles in India as stated below:

- Restriction on domestic banks to provide loans to corporates for the acquisition of shares of Indian companies in the majority of the sectors
- Restrictions to raise external commercial borrowings preventing Indian entities to obtain foreign loans to acquire capital instruments
- FDI caps in many sectors

While there are restrictions as mentioned

above, there are models in the form of a foreign holding company structure, an Indian holding company structure, and an asset buyout structure which can be evaluated to undertake a Leveraged Buyout transaction.

Role of distressed assets and way forward:

the Insolvency and Bankruptcy Code (2016) had led to a surge in global investor interest in India's distressed assets space, with a large volume of activity seen in 2018 and 2019 — touching $3-4 billion. Though the famous dirty dozen cases took longer to get resolved, these cases have set precedents in the stressed assets market. One of the marquee cases to get resolved in this space was Bhushan Steel Ltd which was acquired by Tata Steel Ltd through Bamnipal Steel Ltd (SPV floated for this acquisition). This was a classic case of Leveraged Buyout.

The investment in BSL through BNPL has been done through a combination of equity of ~INR 160 Cr and an inter-corporate loan of ~INR 35000 crore. The acquisition is being financed through a combination of an external bridge loan of Rs16,500 crore availed by BNPL, with the remaining Rs18,700 crore coming in the form of equity infusion by Tata Steel in BNPL. The bridge loan availed by BNPL is expected to be replaced by debt raised at BSL over time.

Sr. No.	Compnay Name	Resolution applicant	Debt (USD billion)	Case Status
1	Bhushan Steel	Tata Steel	8	Successful
2	Elctrosteel steels Ltd.	Vedanta	2	Successful
3	Monnet Ispal And Energy	Consortium of JSW and AION	1	Successful
4	Jyoti Structures	Group of HNIs Headed by Sharad Snghi	1	Successful
5	Alok Industries	RIL and JM Financial ARC	4	Successful (but not yet implemented)
6	Bhushan Power & Steel	JSW	7	Successful (resolution plan challenged; before courts)
7	Essar Steel	Arcelor Mittal	7	Successful
8	Jaypee Infratech	NA	1	Ongoing
9	Era Infra Engineering	NA	1	Ongoing
10	Amtek Auto	NA	2	Liberty House failed to make payment; process restarted
11	Lanco Infratech	NA	7	Liquidation
12	ABG Shipyard	NA	3	Liquidation

Normally, a distressed firm is laden with debt, and hence funding the acquisition through self-funded equity contribution is normally challenging for an investor. To make the proposition viable, the investors have been taking the route of leveraged buyouts and rely on the turnaround of the target for repayment of such debt. With distress space growing and maturing in India, LBOs will find stronger foothold in the M&A space.

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The return of a hostile world- Common strategies against hostile takeovers

Often used as a symbol of U.S. style capitalism, and as shown in the 1987 movie classic "Wall Street", hostile takeovers were pretty popular in the U.S. in 1980s. However, unsolicited bids have become extremely rare over the past decade. The driving factors for this have been the increased antitrust regulations and the 11-year bull market in the U.S. that existed before March, with the all-time high stock prices making potential target companies too expensive.

All this changed over the past few months, with hostile takeovers making a come-back in U.S. and worldwide. This is not surprising considering the pandemic caused several distortions in the stock market. Even though the major indices have recovered from their nadir in March, the recovery has not been similar across all sectors. Many companies having great market positions but depressed stock prices, are affordable now to hostile bidders even at significant premiums. 12 new hostile takeover approaches were announced in Australia in Q4 2020, according to data compiled by Bloomberg.

What is a hostile takeover?

Hostile takeover is the acquisition of a Target company by an Acquirer by going directly to the Target company's shareholders against the wishes of its board of directors. Companies enact defences against hostile takeovers to protect their independence and current management initiatives, or to help ensure that hostile bidders are pressured to present their best offers.

Anti-takeover strategies

Anti-takeover strategies are usually classified as preventive or reactive. Preventive measures are taken beforehand to make the firm less attractive as an acquisition target. Reactive measures are used as an eleventh-hour defence when a hostile attack has begun from an unwanted suitor. Believing that share holder wealth is often best served when a firm is acquired at a premium, they refrain from signalling a lack of receptiveness to being acquired by forming permanent barriers.

Types of preventive strategies

1. Poison Pills

A poison pill is a defence strategy in which the target company offers its stock holders preferred stock in the merged firm—at a highly attractive price—as a mandatory consequence of a successful takeover. This dilutes the stock so much that the attacking firm loses money on its investment. Netflix had resorted to a poison pill in 2012 after the famous "corporate raider" Carl Icahn had acquired a 10% stake.

2. Corporate charter amendments

This involves staggering the elections of members of the board of directors of the target firm. The logic is that a well-established board will be able to fend off an attacker's advances.

2. Golden Parachute

Golden Parachutes are lucrative compensation packages offered to senior executives if a pre-specified threshold of outside stock ownership is acquired in a takeover bid. This is intended to help executives resist takeover attempts (that possibly endanger their jobs) by aligning their wealth more closely with shareholder interest. The high cost to an acquirer of paying off such golden parachute obligations also inhibits some takeover attempts. Meg Whitman, former CEO of HP, reportedly had a contract to receive $9 million if there was a change of control at the company.

Types of reactive anti-takeover strategies

1. Greenmail

Greenmail involves repurchasing the shares of stock that have been acquired by the suitor at a premium in exchange for an agreement that the acquirer will no longer target the company for a takeover. Some jurisdictions impose a tax penalty on corporations making a greenmail payment, and thus this defence method has declined dramatically in the last few decades.

2. Standstill agreements

A standstill agreement is a contract between the parties in which the pursuer agrees not to acquire any more stock of the target firm for a specified period of time in exchange for the firm paying the pursuer a fee. Such agreements usually include a clause that allows the target firm the right of first refusal in the event that the attacker decides to sell its portion of stock.In 2019, video game retailer GameStop had signed a standstill agreement with a group of investors who wanted changes in the company's governance, believing the company had more intrinsic value than the stock's price reflected.

3. Capital structure changes

A firm can restructure its capital to defend against a hostile takeover. Four principal options are available: recapitalizing, assuming additional debt, approving the sale of additional stock, or buying back outstanding shares. All of these ways are intended to either increase the control of executives by giving them more voting power or to make it costlier for any bidder to gain control of the firm.

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A perspective on successful and unsuccessful M&A transactions

Mergers and Acquisitions (M&As) are always eventful – for a casual business newsreader, for a business school student, but majorly for Investment Bankers and company management. M&As are pursued with great zeal, even as statistics say that 70-90 percent (source 1) of M&As result in failure. Companies either overpay for the target, walk away from a high-value target, getting stuck on prices, or do a botched job of post-merger integration.

A lot of literature exists in this area, both in academic research and management journals. With start-up acquisition by corporates gaining more prominence (Reliance-Urban Ladder) and companies adapting to new playbooks for M&A's more research and analysis is always expected in this area. For example, if the HUL – GSK India deal is considered (announced during December 2018), the deal valued the latter at approximately Rs. 31,700 – around six times HUL's annual profit. While size-wise,it would not be the biggest acquisition, it would take ten years for the investment to pay off, assuming that cost of capital for HUL would be at 9% and the excess net profit generated by the target is at Rs. 1000 Crores and grows at 15% per year (HUL's CAGR over the last ten years is approximately 10%). These are arguably liberal assumptions but serve to highlight the fact that while operating over such a long-term, risks for a deal not paying off as expected are high, especially in this deal, when Covid-19 lockdowns would have had a big impact on the math.

Figure 1 – HUL's share price trends (Data from Yahoo finance; daily closing price plotted)

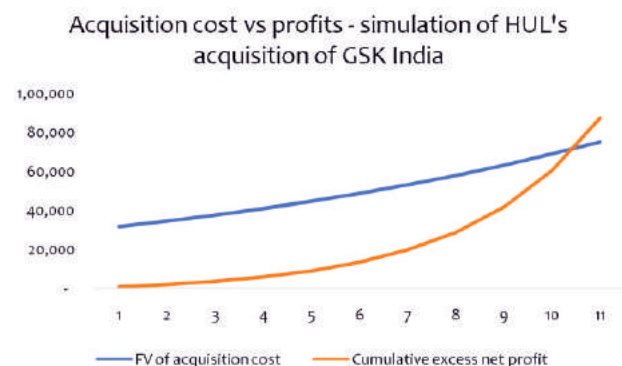

Figure 2 – A simulation of the payback time for Rs. 31700 that HUL paid for the GSK India acquisition. Source: Author's calculations, under said assumptions

Although such uncertainties exist, M&As continue to be popular in companies' quest for diversification, operational synergies, and market power. Hence, it must be understood that when companies tend to overpay for acquisitions.

A school of thought says that just like the advice for human beings, the focus should

not be on taking but giving. When the acquirer is focused on how the target can help its own business, the targets are quick to realize the same and recognize their bargaining power on the negotiation table. The result isan inflated price for the acquisition that becomes hard to recover even after realizing the operational synergies. However, if the focus is on how the acquirer can help the target's business, the negotiation takes a different angle, and the price may not become too high to recover. (Martin, 2016)

Another school of thought different-iates between synergies as the acquisition of resources and acquisition of business models. For example, acquiring a competitor operating in the same market may provide the acquirer a higher market power and hence, the ability to charge higher prices to earn more revenue. The cost-cutting argument is likely to work when the business operates in a high fixed-cost landscape. Acquiring a competitor is likely to add lesser value with an increasing proportion of variable costs in the business model. When access to resources is the main motivation behind an M&A attempt, it is possible that the value-add and synergy benefit available from the deal is limited. This is because high growth in stock prices or abnormal returns are achieved when the firm is able to deliver growth that was not anticipated by investors and the market. The market can quickly react to resource acquisition. However, a deal that enables the acquirer to utilize tacit resources and disrupt its own business model can be expected to be highly valuable. For example, two high-profile Tata acquisitions happened in the first decade of the 21st century – Tata Motors' acquisition of JLR and Tata Steel's acquisition of Corus. The former is widely considered successful, despite recent struggles in JLR, and the latter has been criticized in the popular business press. JLR provided Tata Motors not just an entry into the high-end luxury car business but also skills and talents to design, engineer, and roll out better cars. It is easier to recover the cost of acquisition in such deals because the entire business model gets a dose of steroids. (Christensen et al., 2020)

Recent empirical studies have come up with interesting insights. The long-term gain from an M&A transaction depends on the financial condition of the target before the acquisition. The competency of the acquirer is definitely added into the mix. Lower debt-ratio of the acquirer has been found to correlate with a higher probability of M&A effect. The liquidity position of the acquirer prior to acquisition has also been found to have a positive impact on the value of the deal. (Alhenawi& Stilwell, 2017)

M&As can be expected to generate high buzz among business and finance circles due to the way they change market scenarios. Companies and executives will also learn to handle the deals better. From a research side, academic modeling will continue to throw a positive light on the predictors of M&A success.

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By **K.M. Tejkiran**
Having obtained a B.Tech in Chemical Engineering from IIT-Madras, K M Tejkiran worked at Axis bank for 2 years, after which he joined IIM Ahmedabad. He has been developing a keen interest in finance and picking up writing as a hobby.

BIGSHOTS EYE ON E-GROCERS

The outbreak of coronavirus shackled many industries in India. The economic growth has nosedived. However, there arose an increasing demand for online grocery delivery companies. Their revenues had gone up even during the prolonged lockdown period. The number of customers availing their services has steeply risen. These positive outcomes made many business giants and entrepreneurs see them as a promising sector to invest their money and time in. Indian business tycoon Mukesh Ambani entered into this segment with the launch of JioMart, a joint venture between Reliance Retail and Jio platforms. Launched in May 2020 (during the lockdown period) as an e-commerce arm of Reliance Retail Ventures Limited across 200 cities in India, it is currently performing exceptionally well with about half-million orders a day. It is probably one of the very few businesses that shoot up after COVID-19 means.

As part of expanding the business, RRVL had announced its deal of acquiring retail, wholesale, logistics, and warehousing businesses of the Future Group in August 2020. This acquisition is a beneficial deal for Reliance as it has a presence in almost all the segments it is acquiring from Future Group. As a part of this deal, Reliance ought to own supermarket stores, convenience stores, wholesale stores, etc., of Future Group. Integrating these with JioMart helps Reliance strengthen the business and outperform the competitors. This deal is essential for Future Group to survive. Retail business is at a loss as people are not coming out of the house to buy from supermarkets as they are generally seen as COVID hotspots. There is also an increasing competition from e-commerce companies to which Future Group could not respond effectively. While there was no business, an increase in rent and interest is unremitting, and this left Future Group with essentially two options; Infuse funds or sell the business. Future Group has chosen the latter. This would also benefit the sectors it retained after the deal like manufacturing and FMCG etc. Future Group gets a non-competence agreement from Reliance and also assistance in financing and investing in the businesses it kept. This deal triggered Amazon, a major shareholder in one of the Future Group's companies called Future Coupons, as JioMart is one of Amazon's competitors. Amazon also won an interim award against Future Group, asking the latter to put the deal on hold. This could affect the progress and future planning of JioMart. Future Group should sort out the issue and execute the agreement at the earliest to prevent losses.

On the other hand, Tata Group, an Indian salt-to-software conglomerate, is negotiating with BigBasket to acquire a significant share from them. Currently,

Amazon, Flipkart, and JioMart are the three deep-pocketed competitors in the grocery segment and has recorded exponential growth during the pandemic induced lockdown. Tata Sons have also pledged a significant amount of capital to its retail arms like Trent, Infiniti Retail, etc., in recent times. It would be an excellent opportunity for them if they could make BigBasket divest. This is necessary for BigBasket to stay in the competition. The other option is to seek financing. But with Tatas in the picture, this deal would enhance BigBasket's brand image. This deal would also help Tata Sons to expand themselves into the retail segment.

Therefore, the online grocery delivery segment is seen as a rapidly growing sector and is expected to double its market within 1-2 years. With COVID upgrading itself with new strains in UK, Australia, etc., I expect the online retail business to rise further and see more companies investing in them.

The views expressed here are entirely personal & do not necessarily reflect any other person or organization's views.

By **Godavarthi Srikanth**
Srikanth is a 1st year MBA student at IIM Lucknow

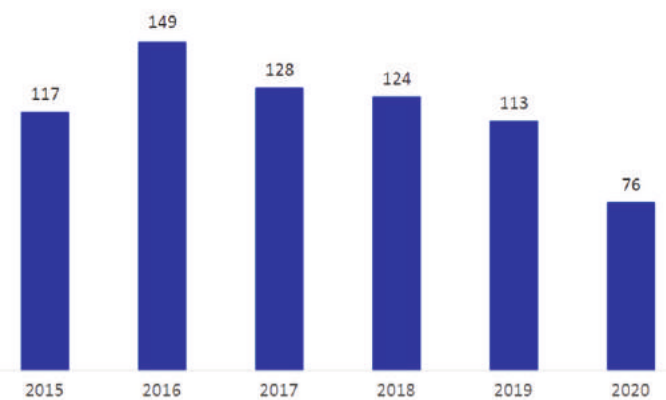
Start-up acquisitions in India

Start-up acquisitions in India over the years

With only a few big players being active in the M&A spectrum, the number of deals in 2020 went down significantly from 113 in 2019 to 76 in 2020 (till November 2020). This decline of

~33% was primarily due to the economic slowdown across the world due to the current COVID-19 pandemic. Deals in 2020 were led by companies looking for distress assets as potential acquisitions.

Number of M&A deals in Start-up space in India over the years



Source: Inc42 Plus

2020 and the impact of COVID-19 on start-up acquisitions

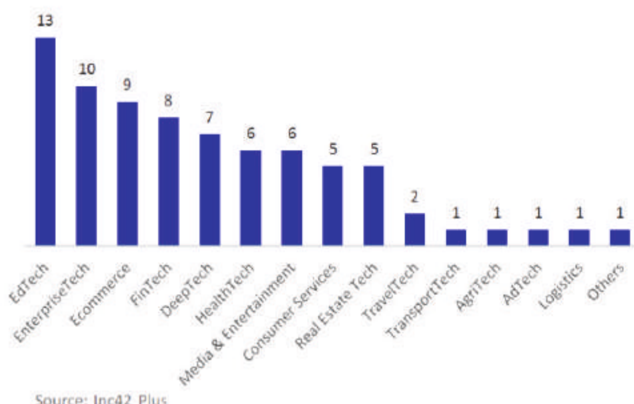
The outbreak of the COVID-19 global pandemic in 2020 has had a devastating effect on start-ups across industries in India. The Indian start-up ecosystem saw unprecedented adverse impact in the form of declining cash flows, disrupted distribution network and steep fall inrevenues.

The negative downturn impacted some start-ups causing their valuations to sink to new lows. This led to a few cash rich unicorns hunting for cheap targets at bargain prices primarily in the field of EdTech, FinTech and HealthTech. Majority of the deals were in the pipeline for the following reasons:

- To plug gaps in digitization of acompany
- Techacquisitions by big companies to acquire smaller ones for its technical prowess
- To Consolidate companies operating in crowdedmarkets
- Acqui-hiring for companies that are running low oncash

Majority of the deals during COVID-19 lockdown were in E-commerce and technology space like EdTech, EnterpriseTech, FinTech etc. as companies wanted to leverage the shift to online consumerism.

Sector-wise split of M&A deals in Start-up space



While most businesses have struggled to find their feet in the toughest phase in recent times in the world economy, some new businesses have emerged as winners with their solutions for a COVID-hitworld.

The Indian EdTech sector witnessed mammoth funding of more than $1.43 Billion in the past 11 months. HealthTech sector also saw a lot of traction by investors who banked upon the opportunities that the likes of Practo promised to harness. Further, E-commerce, online gaming and enterpriseTech solutions such as videoconferencing platforms gained limelight due to transition from personal to online interaction.

Apart from core M&A deals, the start-up space also saw significant number of investment deals across sectors, taking the total tally of deals to 905 in 2020 (till November 2020). Overall, a total of $10.6 Billion has been invested in Indian start-ups out of which 38% was constituted by the top 10deals.

Major Start-up acquisitions in 2020

In the last 12 months, Reliance has entered the Indian Tech start-up ecosystem with full force. In July, it expanded its E-commerce presence by acquiring a minority stake (15% stake) in online lingerie retailer Zivame. In August, it also ventured into the online medicine delivery space by acquiring 60% equitys take for $83 Million in E-pharmacy Netmeds.

Further in November, in one of the major distress deals, Reliance acquired 96% equity stake for $25 Million in Urban Ladder, a digital platform for home furniture and décor products. The online furniture retailer has a chain of retail stores across several cities in India and was valued at ~$160 Mn in 2018 and ~$100 Million in 2019 before its valuation was significantly impacted by the COVID-19 pandemic.

One of the largest acquisitions in the start-up space was done by the EdTech unicorn and online tutoring platform BYJU's which acquired Mumbai based WhiteHat Jr. for $300 Million in August. WhiteHat Jr. was founded in 2018 and is an online one-to-one coding platform that teaches the principles of coding to young kids, as such skills are not a part of the formal education system in India. Prior to the acquisition, WhiteHat Jr. had raised $11 Million from investors like Nexus Venture

Partners, Omidyar Network India and Owl Ventures and had also achieved a revenue run rate of $150Million.

Apart from the above mentioned BYJU's acquisition of WhiteHat Jr., EdTech also saw a lot of significant deals such as

- BYJU's acquisition of Unitus-backed LabinApp, a platform that enables students and teachers to perform science activities and experiments on various devices.

- Unacademy's acquisition of post-graduate medical entrance exam preparation platform PrepLadder for $50million.

- 51% Equity stake investment by Unacademy for $5 Million in Mastree, an e-learning portal offering live maths and science classes

- Computer programming Platform, Code Chef's 100% acquisition by Unacademy

- Unacademy's acquisition of online education platform Kreatryx to strengthen GATE and ESE Preparation

In general, 2020 has been a tough year for the start-up ecosystem. However, we have seen traction in tech based start-ups offering unique solutions foreshadowing the dominance of technocology in the coming future.

By **Udhav Khanna**
Udhav is a 1st year MBA student at IIM Lucknow. He completed his Bachelors degree in Financial and Investment Analysis from SSCBS, University of Delhi in 2017, and has worked with KPMG India in their Investment Banking team for 3 years. He is currently a member of Credence Capital, tracking opportunities in FMCG and Automobile sectors.

SPAC: IS IT A FAD OR LONG-TERM SHIFT?

1. Introduction

We have been hearing a lot about SPACs this year. SPACs are not a new thing and have existed since 2003 in its current form. However, they have got into the limelight this year due to some big name investors jumping to the bandwagon.

SPACs are short-form for "Special Purpose acquisition company" which is a corporate shell or blank-checkcompany. Typically, aSPAC sponsor(well-known investor) commits his own capital along with other investors to take a private company public by doing a reverse merger. SPAC gives the target company a tailor-made listing in the public market without an initial public offering.

2 What triggered SPAC proliferation in2020?

SPACs existed since 2003 however they gained momentum in 2020 due to the following reasons:

- Economic and market turmoil caused by the COVID-19 pandemic at the begin ning of the 2020 has created conditions ripe for SPAC investment opportunities.
- Some not able VC sand founder shave questioned the efficacy of the IPO process due to the uncertainty and complexity involved. This has discouraged many large private companies from going public with IPOprocess
- Many of the private Unicorn companies have chosen to remain private longer. But the disappointing IPO out comes in 2019 and urgent liquidity needs due to Covid cris is have compelled these companies to source funding through alternate vehicles.

3. Comparison of SPAC with IPO and other financing methods

	SPAC	IPO	Direct Listing
Fundraising process	Upfront committed capital; less uncertainty of the proceeds	Price and offering size is determined by the investment bankers based on the investor demand	Sell the shares on the stock exchange directly and let the market discover the right price
Associated Cost	Big commission for the sponsor to identify the target company	Investment bankers charge high commission fees and also get the sizeable portion of the shares at a discount by bearing the underwriting risk	Low cost as less fees are paid to the advisors or bankers however more risky in a bearish market scenario
Leaving money on the table	Price negotiated upfront with the sponsor which can result in the significant IPO pop after the company goes public	Price negotiated upfront with the large investors which can result in the significant IPO pop after the company goes public	Most efficient price discovery mechanism as price is determined via the market auction on the day of listing
Risk	Low risk since price and offering size are negotiated between sponsor and target company in advance	Medium risk; large investors may show lukewarm response to the offering in difficult market conditions ex. We Work	High risk since listing may not be able to generate enough interest in the offering resulting in the failure of raising proceeds

4. SPAC space in2020

According to the NY Times Deal Book, 242SPACs were introduced this year which is more than four times the number raised last year. Below are some of the major highlights:

- Bill Ackman, a successful hedge fund manager, raised a record $4 billion for a SPAC in July 2020

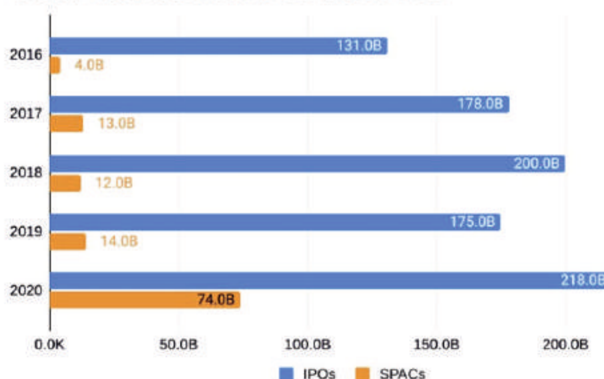
- The venture capitalist Chamath Palihapitiya raised a series of funds for SPAC.He took Virgin Galactic and Open door public via SPAC

- French billionaire Xavier Niel raised $368 million for a blank-check fund which will be the biggest in France this year

- Nikola and Draft Kings were some popular companies among many others which went public this year through the SPACroute

5. Deal volume and size in 2020

As of December first week, nearly 45,000 deals worth $3.4 trillion had been announced this year, down 8 percent by number and 7 percent by value from the same point a year ago, according to Refinitive. It was also reported that the decline was much worse at middle of the year when deals were down 40 percent by value.



Source: Refinitiv, NYTimes

6. What can go wrong?

Deal makers predict continued growth in blank-check funds a.k.a SPACs and a rise in takeover activity in general in 2021. However, there are following down sides of raising money via SPAC:

- People who invest in SPACs have different goals than a normal in vestor
- SPACs may be more expensive than an IPO due to hidden cost elements.
- Public in vestor may bear the cost of in adequate due diligence on the business of a SPAC merger compared to the IPO

Too much spotlight on SPACs may also prove their vulnerability. Goldman Sachs estimates that 193 blank-check funds are currently sitting on $63 billion in search of takeover targets. SPACs are contractually

obligated to return money to the investors if they couldn't find a merger target within two years. This may result in crowding of investors to close out deals much faster without proper due diligence.

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IIML 2015-2017 batch. Part of Credence club. Major in Finance and Strategy Ashish is part of Deloitte Consulting M&A Integration and Divestiture practice. He has experience in M&A Day-1 planning, Post-Merger Integration Planning, strategic roadmap, and program management. Before MBA, Ashish was part of the 4G telephony software development in the Altran Technologies.

IS ALLOWING INDIAN CORPORATES/INDUSTRIAL HOUSES TO OPEN BANKS A GOOD IDEA?

In the last week of November 2020, Reserve Bank of India's (RBI's) internal working committee ('IWG') recommended issuing banking licenses to large corporate and industrial houses to increase competition in India's banking sector. This means that such corporate or industrial houses can take significant stakes in banks or set-up their own banks, something the RBI had strongly objected to in the past. On eligibility of the promoters, the working committee said that the big corporate/industrial houses may be allowed as promoters of banks after required changes to the Banking Regulations Act, 1949 to take care of connected lending and exposures between the banks and other financial as well as non-financial group entities. The other significant proposal that was announced was to allow large non-banking financial companies (NBFCs) with asset size of 50,000 crores and above and with a decade's track record, to convert to banks. The working group also suggested to raise the upper limit, from the current 15 per cent to 26 per cent, on promoters' stake in private banks in 15 years.

India needs more Banks

India is still brutally under banked. As per World Bank data, India's domestic credit to private sector as a percentage of GDP in 2019 is about 50% which is woefully short of what a fast-growing economy needs. The comparative figure for China, 'high-income' countries and 'middle-income' countries is 164%, 147% and 107% respectively. Currently, India has 12 public sector banks, 22 private sector banks, 44foreign banks and several regional and co-operative banks. Of these, the public sector and private sector banks account for the bulk of loans advanced and deposits accepted. As of 2020, public sector banks account for ~ 60% of the loans advanced and ~ 65% of deposits accepted.

MARKET SHARE IN LOANS (in percentage)

Year	Public sector banks	Private sector banks	Foreign banks
2000	79.41	12.56	8.03
2005	74.25	19.21	6.54
2010	77.24	18.08	4.67
2015	74.28	21.26	4.45
2020	59.8	36.04	4.15

Source: RBI

Infographic: Ramandeep Kaur | ThePrint

MARKET SHARE IN DEPOSITS (in percentage)

Year	Public sector banks	Private sector banks	Foreign banks
2000	81.29	12.63	5.47
2005	78.16	17.12	4.7
2010	77.68	17.31	5.05
2015	76.26	19.44	4.3
2020	64.75	30.35	4.89

Source: RBI

Infographic: Ramandeep Kaur | ThePrint

While the share of private sector banks has increased drastically in the last decade or so, it is absolutely in disputable that India needs more banks, and that too efficient ones. If India wants to achieve its target of being a five trillion dollars economy by 2025, it needs a robust, deep, and competitive banking sector. Competition is often deemed as a necessary pre-condition for promoting efficiency and innovation in all sectors including the banking sector. The IWG also believes that the entry of corporate players would lead to a greater competition in the Indian banking sector.NBFCs backed by large industrial houses — think Bajaj Finserv, M&M Finance, Tata Capital, and the likes— had evinced interest for banking licenses earlier and will be encouraged by the developments. However, they will have to weigh the trade-offs of strict(er) regulations faced by the banks vs. cheaper source of funds available to banks before making any decision. If these recommendations are accepted, this will mark India Inc's re-entry into commercial banking after 40 years from the last round of bank nationalisation in 1980.

Pitfalls of giving banking license to corporate houses

The camp against the idea of entry of corporates into Banking was led by the formidable duo of Raghuram Rajan and Viral Acharya.In a LinkedIn post titled – "Do we really need Indian corporations in banking?" – they laid out their reservations in no uncertain terms.The IWG report itself lists several risks, including conflicts of interest, misallocation of credit, risks relating to intra-group transactions, extensive anti-competitive practices, moral hazard risks, and the risk of contagion. Despite recognising such risks, the IWG has endorsed the entry of large corporate houses in the banking space. Further, corporate ownership of banks may lead to further concentration of economic power in the hands of a big corporate and industrial houses which would have adverse effects on the domestic economy and politics. It may not only widen inequalities but would also lead to policy capture where special interests would shape public policies.

Closing Thoughts

The entry of corporate houses into the lending space would also require increased regulatory oversight by the RBI, far more than that required over the existing players. The question is with all the existing problems of NPAs and corporate governance on hand, does the RBI have additional bandwidth to adequately oversee corporate houses and industrials.

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By **Pratik Gandhi**
Pratik Gandhi is a Chartered Accountant and currently in his final year of MBA at IIM Calcutta. He co-manages Joka Advantage Fund 2020-21, a student-run investment vehicle. He has also cleared CFA Level 3 exam.

Is India a currency manipulator?

Consider the laws of demand and supply. The value of a commodity rises when there's considerable buying pressure and it tumbles when people start selling it en masse. It's the age-old maxim that applies to almost everything you see around you, including currencies. So when the Reserve Bank of India shows an insatiable desire to buy the Indian currency by selling the US Dollar, then you are most likely to see an appreciation in its value. And when they start selling the rupee in exchange for dollars, then the value of our currency depreciates. It's that simple.

Now, most people baulk at the mere suggestion of willfully depreciating a currency. I mean, why do it at all? But believe it or not, there is considerable merit in engaging in such an exercise. For one, if you are looking to boost exports, then a cheap currency is a godsend in many ways. Think about it. You have two use cases.

1. Before depreciation-Where a dollar gets you 70 rupees.

2. After depreciation-Where a dollar gets you 75 rupees.

So if you're in the US and trying to import stuff from India, then you can buy a lot more when the currency depreciates. It's just math and it's not always a bad thing to let the currency slip in value. However, if you let it slip too much, then that begets its own set of problems. Thankfully, most people don't think we are there yet. But that doesn't mean we are out of the woods. A couple of days back the US treasury department put us on the currency manipulator watch list. Meaning they think we could be deliberately devaluing our currency in a bid to gain an unfair advantage. But how can they tell if we are doing something like this. Well, the US Treasury uses three benchmarks to judge currency manipulators.

1. A bilateral trade surplus with the U.S. of more than $20 billion Meaning, if we export more to the US and then don't import a lot, we have to make sure that the difference doesn't breach $20 billion. If it does, then the US might flag us for being a currency manipulator. After all, if we start dumping our products at cheap prices in the US, then it hurts local manufacturers in America and if you tally the numbers from June 2019 and

June 2020, you'll see that we've actually breached this threshold.

2. A current account surplus of at least 3% of GDP When our exports far exceed our imports, it could potentially be a sign that we are using a devalued currency to dump cheap goods abroad. Thankfully, India hasn't breached this limit yet.

3. Net purchases of foreign currency of 2% of GDP over a 12-month period

That's to say we are buying a lot of foreign currency and selling too little. And while it's okay to dabble in such an exercise from time to time, overdoing it can be an indication that you are deliberately plotting to devalue the rupee — at least according to the US. And on this front, we seem to have breached the limit.

Once again, I want to reiterate one thing here. They haven't branded us as a currency manipulator. In fact, the US treasury commended the RBI for being transparent about its intervention. And so they just put us on the watchlist which also includes other countries like China, Japan, Korea, Germany, Italy, Singapore, Thailand, Taiwan and Malaysia. However, they did brand Vietnam and Switzerland as active manipulators. So, yeah, they have a problem on their hands.

Or do they?

I mean, we haven't yet talked about what really happens after you get branded as a currency manipulator. What is the US going to do? They're just a country like any other, right? Well, yes, but they do wield considerable influence. For starters, once you're tagged as a manipulator, they'll most likely work with you in a bid to correct this disparity. In the event, you don't follow through with their suggestions, then there will be some backlash. According to reports, it's likely that the US could limit access to government contracts and development loans to countries that violate this tacit arrangement. So yeah, it's not a nice thing to be on this list and hopefully, we can continue looking after our interest while not breaching those other conditions.

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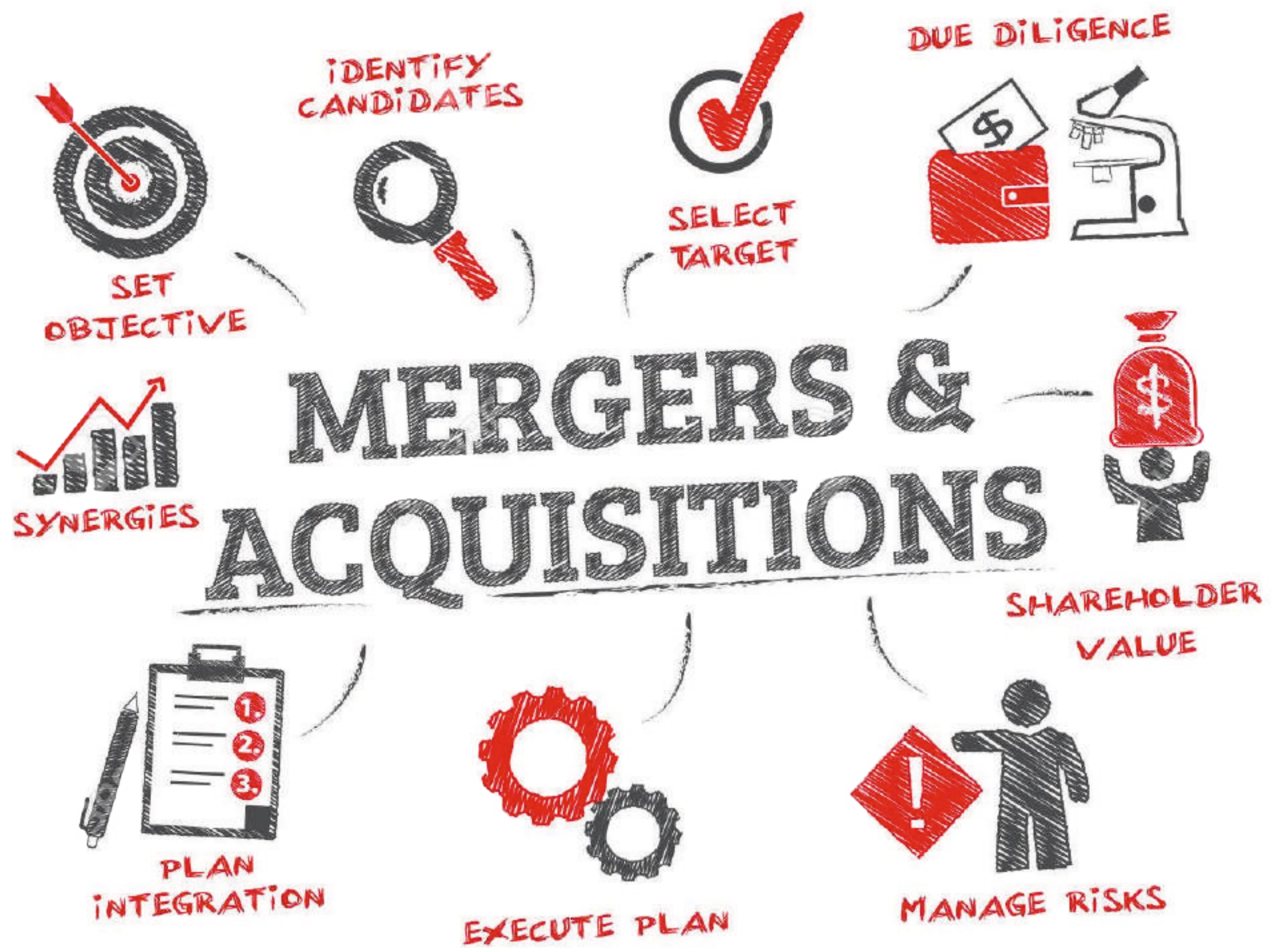
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SELECT TARGET
DUE DILIGENCE
SET OBJECTIVE
MERGERS & ACQUISITIONS
SYNERGIES
SHAREHOLDER VALUE
PLAN INTEGRATION
EXECUTE PLAN
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