Risks Mitigation Strategies under an Merger & Acquisition Transaction

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Mergers and Acquisitions ("**M&A**") are one of the most preferred methods for inorganic growth of businesses. However, M&As can go wrong due to various reasons: overenthusiasm about unquantifiable strategic benefits of the deal resulting in over valuation of the acquired company; post deal integration issues in systems, processes, human resources leading to lack of synergies; mismatch between vision and operating strategies of the new and old managers; undisclosed/unexpected liabilities or claims causing a dent in the benefits of the M&A, etc.

A failed M&A can lead to adverse impact on established systems and work processes, damage the company's reputation, erode goodwill and diminish customer confidence, cause erosion of employee's moral and cause employees to leave. All failed M&As necessarily lead to destruction of shareholders' value.

While the legal experts usually focus on negotiating and capturing the critical provisions relating to commercial understanding, representations and warranties, indemnification liabilities, mitigation measures, limitation of liabilities, exit options and dispute resolution mechanisms, there are several other nuances to an M&A deal which may play a greater role in potential failure of the M&A deal and consequent loss of shareholders' value. A few of these examples, which highlight how things can go wrong in an M&A deal for reasons which could have been easily mitigated, are discussed below:

Recommended by:

A. **Trust but Verify**

The most basic rule of managing risks is to undertake a legal, commercial and financial due diligence exercise to assess the assets, debts and liabilities of the target entity. However, the danger is not that no due diligence is undertaken but that it is not done well, or that the risks flagged in the due diligence are ignored as the acquirer has*'fallen in love with the deal'* and has chosen to ignore the identified risks, or in a worst case scenario the managers have trusted the assertions made by the promoters of the acquired group without conducting a physical asset/stock assessment.

Undertaking a physical asset/stock evaluation is particularly critical in a cross-border acquisitions or in business transfer arrangements where assets being acquired are core to the transaction. For instance, not making an onsite visit to the factory of Ranbaxy was one of the key reasons for the failure of Diachi and Ranbaxy deal. To elaborate, when an acquisition is of an undertaking or a business through business transfer or acquisition and the large part of the value is being ascribed to the assets being acquired then conducting a physical inspection of the actual stock, checking for expiry dates, storage facilities on the ground is a must to ensure that the acquirer knows exactly in real terms what it is acquiring and the valuation is fixed accordingly. Simply relying on excel sheet figures can be fatal to the deal and its future.

B. **Mapping Expectations**

Often minority acquisitions come with a majority mind-set and there are disconnects later on between the majority promoters and minority stakeholders, particularly when it comes to a say in the operations. If the acquirer is seeking minority stake/control, it needs to be clear on the role it envisages for itself i.e., is it satisfied with the exercise of affirmative consent/veto rights through board processes, or does it want a larger voice when it comes to operations and management. In case of the latter, be very sure that the promoters of the investee entity are aware of these expectations and the same are mapped upfront both commercially and legally in the transaction documents.

C. **Keep your advisors involved till the very end**

An M&A deal can go wrong not just for the acquirer but also for the target entity and its promoters. The common tendency of the promoters is to involve the advisors in the initial stage but as the closure compliances are being handled, the advisors are usually not involved. This could sometimes prove fatal especially when there multiple closing and post-closing compliances and obligations. For example, in one of the cross border deals, a part of consideration was being withheld in an escrow arrangement, towards indemnification obligations of the sellers, for a particular period. The

consideration was to be put in the escrow simultaneously with business transfer closure. While the transaction documents recorded the above understanding, the target entity, at the time of closing, did not keep the legal or financial advisors in the loop. What this resulted in was that the offshore acquirer did not transfer the balance consideration into the escrow account at the time of transfer (orally agreeing to transfer it within the next few days) and the share transfer deed were signed before remittance of such balance consideration. This was a case of 100% acquisition. Its' been 2 years, but the balance consideration has still not been paid on the pretext of fictionary indemnification liability – the cost of initiating an arbitration vs. the claim is now holding the promoters back. This situation however, could have been easily avoided, if the advisors were kept on board till the very end so that all the closure checklist were ticked off. So it's not enough to negotiate the documents, it is equally important to implement the understanding agreed under the documents.

A lot of time, costs and efforts can be avoided if certain fundamentals are thoroughly evaluated and over enthusiasm and excitement of the managers looking to '*close the deal at any cost'* are kept at bay. Otherwise the gap between expectations and actual performance can lead to a failed M&A deal and consequent erosion of shareholders' wealth.

Feedback

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