

## Post-Merger Reorganisation

### Introduction:

Post-merger reorganisation' is a wide term which encompasses the reorganisation of each and every aspect of the company's functional areas to achieve the objectives planned and aimed at. The parameters of post merger reorganisation are to be established by the management team of every amalgamating company differently depending upon its requirements, objectives of merger and management corporate policy.

A merger can join two cultures, two sets of procedures and protocols, two sets of policies and change the employment environment and prospects of several hundreds of employees, who have been the bed rock of past successes and the key to future value. Timely integration of systems, applications and data provide the corporate information needed to achieve the post-merger objectives.

In fact the main reason, why so many mergers either fail or fall short of expectations is a lack of adequate efforts to integrate the purchased company into the buyer's existing operations. It should be realised that once the deal is put through, the 'real' work has only begun. Often, the buying company underestimates as to how long it will take to get the two companies to act as one. Therefore, where importance is placed on whether it is a good idea to purchase a company and figure out the right price, it is equally essential to understand the target company with an eye to post-merger efforts.

### FACTORS IN THE POST MERGER REORGANISATION

It would not be inappropriate to divide all actions in the restructuring process in three stages viz. before, during and after, to ensure all actions are covered and put in right buckets to ensure proper planning for each of these actions. Post-restructure actions envisage actions required to be taken after the approval from the Court is obtained in case of a merger of two or more companies.

1. **Change of name and logo** If the restructure is going to result in change of name or where the Board of Directors decide to change the name of the entity post restructuring, the company will need to plan implementation of change of the Company has been posted/displayed, including company's website/internet. Similarly, actions need to be taken to modify the corporate logo, if the same is going to change as well.
2. **Revised organization chart** The company will need to work on updating its organization chart at all levels. It will need to reflect the new vision/mission, new thinking post restructure. Also, changes may be necessitated by vertical/ horizontal structures in the organization.
3. **Communication** The company should provide proper and timely communication about the restructuring in the organization to all its employees, which would provide updated status, bring clarity on what's happening at the organizational level and avoid miscommunication. Also, it would be useful to send a communication regarding changes in company policies as well. The company should also consider sending appropriate communication to bankers, auditors, advisors, etc. upon formal completion of the restructuring activity.

4. **Employee compensation, benefits and welfare activities** Companies need to be sensitive with regard to terms and conditions of employment. Usually, courts would uphold terms of employment to be no less favourable than existing terms and conditions. Post acquisition, the parent company may want the acquired company to adopt compensation structure of the parent entity. It would result in re-aligning the structure as well as pay scales of existing employees.
5. **Aligning company policies** The company would need to align/ amend its internal policies to reflect the organization in the post restructure scenario. This may not apply in all types of restructuring. Particularly in case of takeover, the acquiring entity is likely to insist all its policies on the acquired entity to bring consistency in the groups' policies. Specific changes to group policies may be needed depending on nature and size of business, location, applicability of relevant State laws.
6. **Aligning accounting and internal database management systems** Besides passing appropriate accounting entries to capture the merger/ acquisition/ financial structure, the company may need to adopt accounting policies, practices based on those followed by its new parent organization post acquisition. The company needs to understand any reporting and database requirements of acquiring company or merged entity to provide relevant data to the new management and to align existing systems with those of the parent/ merged entity.
7. **Re-visiting internal processes** The company which is subjected to restructuring will need to align its internal processes with that of the merged entity/ acquired entity e.g. domestic travel process, reimbursement of expenses process. Company's current process may involve issue of cheques to employees against expenses claimed; whereas merged/ acquiring entity credits its employee claims to a bank account maintained for the purpose.
8. **Re-allocation of people** Restructuring typically would entail re-allocation of persons operating on various positions/ grades in similar functions. At times, allocation in support functions becomes a challenge as now two persons handle the similar profile e.g. personnel in HR, finance, administration etc. This would require re-allocation of responsibilities or re-defining the responsibilities to specific geography/ line of business/ business units.
9. **Engagement with statutory authorities** This is one of the important areas that deals with legal requirements and is close to the company secretary. It is essential to identify government authorities that need to be intimated formally about the merger/ amalgamation/takeover e.g. SEBI, Stock Exchange etc.
10. **Record keeping** Maintenance of records of merging entity and making suitable entries in the records of merged entity is a must. One will need to dive deep to ensure maintenance of all past records including statutory and non-statutory registers, original copies of various forms, returns, certificates, approvals, litigation and property records. Company may need to relocate the records to centralized storage maintained by the merged/new entity.
11. **Immoveable Property** A restructuring may cause changes in property records e.g. consequent to merger if merging entity ceases to exist, merged entity would need to take steps to ensure that property records are updated to reflect the name of the merged (new) entity.

12. **Expansion of existing teams to support larger organization** A restructuring is likely to put pressure on support staff, which was supporting employee strength before amalgamation e.g. in-house training department was probably handling technical training for 2000 employees. Post amalgamation with another company, the training function needs to cater to training requirements for 5000 employees.
13. **Revised ISO certification and similar other certifications** Restructuring could lead to changes in existing certifications such as ISO or similar other certifications. With the addition to locations or changes in organization structure, suitable changes need to be reflected to the certifications obtained.
14. **Re-visiting past decisions/government approvals/ compliances** Restructuring is not always about future decisions or actions. One would need to take a look at past decisions or approvals which were conditional and insist for re-visiting earlier decisions
15. **Contracts** It is a onerous exercise to check provisions in the existing contracts having connection to any form of restructuring. While order of the Hon'ble Court would prevail and shall ensure that the contracts entered by the merging entity shall continue to be transferred in the name of merged entity as if merged entity was the signing party from the relevant date, provisions contained in a contract with third party may require company to inform about such merger or may give rise to the other party to terminate the contract.

### INTEGRATION OF BUSINESSES AND OPERATIONS

Recognizing the importance of mergers in the success of a company, it is important to discuss some critical aspects that should be taken into account in the integration stage of a M&A deal

— Focus on people and their incentives: Innovation is not a mechanical process but depends on key employees and the incentive structure to which they are subject. These, which are perhaps the most important assets of the firm, are nonetheless not automatically part of the deal but need to be co-opted into it. Just maintaining the R&D budget will not necessarily do the trick. Subtle changes in the vision, leadership or organization of the newly-formed firm can have important effects on how potential innovators perceive the relevant costs and benefits.

— Integrate selectively: It may make sense to integrate the distribution operations of two employees. It hardly makes sense to integrate their creative units. Competition has to be maintained in the areas where innovation is more important and intense. The areas where the processes are more standardized and less human capital-intensive are in general more amenable to integration.

— Do not delay decisions and communicate clearly the new rules: As any other economic activity, the efforts put into innovation critically depend on the expected rewards. Delaying or ineffectively communicating the new rules of the game unnecessarily brings additional uncertainty into the process. Highly mobile human capital may well not be very patient.

Suppressing competition with coordination and control may not be a win-win proposition after all. Constant innovation and adaptation is critical for the long-term survival of an organization. Without competition- the fear to fall behind — there is not much rationale for

constant re-invention. This fact must be taken into account in the way that the various parts of the new organization are integrated.

### **POST MERGER SUCCESS AND VALUATION**

Every merger is not successful. The factors which are required to measure the success of any merger are briefly discussed below.

1. The earning performance of the merged company can be measured by return on total assets and return on net worth. It has been found that the probability of success or failure in economic benefits was very high among concentric mergers. Simple vertical and horizontal mergers were found successful whereas the performance of concentric mergers was in between these two extremes i.e. failure and success.
2. Whether the merged company yields larger net profit than before, or a higher return on total funds employed or the merged company is able to sustain the increase in earnings.
3. The capitalisation of the merged company determines its success or failure. Similarly, dividend rate and payouts also determines its success or failure.
4. Whether merged company is creating a larger business organisation which survives and provides a basis for growth.
5. Comparison of the performance of the merged company with the performance of similar sized company in the same business in respect of (I) Sales, (ii) assets, (iii) net profit, (iv) earning per share and (v) market price of share. In general, growth in profit, dividend payouts, company's history, increase in size provides base for future growth and are also the factors which help in determining the success or failure of a merged company.
6. Fair market value is one of the valuation criteria for measuring the success of post merger company. Fair market value is understood as the value in the hands between a willing buyer and willing seller, each having reasonable knowledge of all pertinent facts and neither being under pressure or compulsion to buy or sell. Such valuation is generally made in pre merger cases.
7. In valuing the whole enterprise, one must seek financial data of comparable companies in order to determine ratios that can be used to give an indication of the company position. The data is analyzed to estimate reasonable future earnings for the subject company. The following information must be made available and analyzed for post-merger valuation:
  - (i) All year-end balance sheets and income statements, preferably audited, for a period of five years and the remaining period upto the valuation date.
  - (ii) All accounting control information relating to the inventory, sales, cost, and profit contribution by product line or other segment; property cost and depreciation records; executives and managerial compensation; and corporate structure.
  - (iii) All records of patents, trademarks, contracts, or other agreements.
  - (iv) A history of the company, including all subsidiaries. Analysis of these items provides data upon which forecasts of earnings, cash flow, etc. can be made.

8. Gains to shareholders have so far been measured in terms of increase or decrease in share prices of the merged company. However, share prices are influenced by many factors other than the performance results of a company. Hence, this cannot be taken in isolation as a single factor to measure the success or failure of a merged company.

9. In some mergers there is not only increase in the size of the merged or amalgamated company in regard to capital base and market segments but also in its sources and resources which enable it to optimize its end earnings.

10. In addition to the above factors, a more specific consideration is required to be given to factors like improved debtors realisation, reduction in non-performing assets, improvement due to economies of large scale production and application of superior management in sources and resources available relating to finance, labour and materials.

### **MEASURING POST-MERGER EFFICIENCY**

The criterion to judge a successful merger differs in different conditions. Different factors may be considered for making value judgements such as growth in profit, dividend, company's history, increase in size, base for growth etc. Several studies suggest different parameters to assess the success of mergers:

- (i) Successful merger creates a larger industrial organization than before, and provides a basis for growth [Edith Perirose].
- (ii) In Arthur Dewing's study, three criteria were considered viz. (a) merger should give a larger net profit than before (b) merger should provide a higher return on total funds (c) there should be a sustained increase in earnings.
- (iii) Earnings on capitalization and dividend records determine the success of merger [Shaw L.]. During the studies in late 1960s, two types of efficiency improvements were expected to result from mergers:
  - (1) improvements due to economies of large scale production
  - (2) application of superior management skills to a larger organisation. Some other researches in the seventies and eighties, measure efficiency based on stock market measures, labour productivity or total factor productivity etc. These improvements pointed towards market dominance, but for gauging efficiency, resultant profitability was accepted as a benchmark. In order to ensure progress, a conscious and concerted effort to keep track of several key elements is required, alongwith answers to the following questions:
    1. What impact is the integration (merger/acquisition) having on key indicators of business performance? Whether synergies which were hypothesized during the valuation are being realized?
    2. Are the activities and milestones developed with the integration process on target?
    3. What are the major issues emerging during the integration, requiring considerable attention?
    4. What important facts have emerged during the merger or acquisition that can be used to improve subsequent mergers or acquisition?

**MEASURING KEY INDICATORS:** The main purpose of a merger or acquisition is to deliver the expected financial results namely earnings and cash flow. However, there are certain other measures that serve as key indicators and they also need to be measured. The indicators may be grouped as:

- (i) Financial outcomes.
- (ii) Component measures of these outcomes namely revenues, costs, net working capital and capital investments.
- (iii) Organisational indicators such as customers, employees and operations. All the areas being integrated and both the acquirer and target, or in a merger, both partners, should be brought within the ambit of continuous appraisal. Also, the appraisal should be based on benchmarks to ensure that merger or acquisition are yielding the financial and strategic objective so intended and are not resulting in value leakage.

There are broadly four possible reasons for business growth and expansion which is to be achieved by the merged company.

**1. Operating Economies** Whenever two or more firms combine, certain economies are likely to be realised as a result of larger volume of operations resulting in economies of scale. These economies may arise due to better utilisation of production capacities, distribution network, engineering services, research and development facilities and so on. The operating economies (economies of scale) would be the maximum in the case of horizontal mergers where intensive utilisation of production capacities will result in benefits for the merged firm. Operating economies in the form of reduction or elimination of certain overhead expenses may also arise even in the case of conglomerate mergers. The net result of realising economies of scale would be a decrease in the cost of production.

**2. Financial Economies** Merger of two or more firms brings about the following financial advantages for the merged firm: (a) Relief under the Income Tax Act Under Section 72A of the Income Tax Act, 1961 carry forward and setting off of accumulated losses and unabsorbed depreciation of the amalgamating company is allowed against the future profits of the amalgamated company in order to encourage revival of sick units. (b) Higher Debt Capacity The merged firm would enjoy higher debt capacity because the combination of two or more firms provide greater stability to the earnings level. This is an important consideration for the lenders since the possibility of default in repayment of loan and interest is reduced to a great extent. A higher debt capacity if utilised, would mean greater tax advantage for the merged firm leading to higher value of the firm.

**3. Growth and Diversification** As stated earlier, merger/amalgamation of two or more firms has been used as a dominant business strategy to seek rapid growth and diversification. The merger improves the competitive position of the merged firm as it can command an increased market share. It also offers a special advantage because it enables the merged firm to leap several stages in the process of expansion. A merger proposal has a very high growth appeal, and its desirability should always be judged in the ultimate analysis in terms of its contribution to the market price of the shares of the merged firm. The merged firm can also seek reduction in the risk levels through diversification of the business operations.

**4. Managerial Effectiveness** It has been pointed out by various studies that incompetency of management has been the most important reason for firms becoming sick. If a sick firm is merged with another well managed company, it will lead to better co-ordination of human resources of both the companies. Managerial effectiveness can also bring substantial gains to the merging firms if two well managed firms combine together to take advantage of valuable human resources.

Customer Reactions It is necessary to ensure that customers are not adversely affected during a merger or acquisition as losing either profitable customers or a percentage of their business may have a negative impact on earnings and cash flows, especially if the customer represents a large percentage of company's revenues and profits. Several indicators may be deployed such as customer satisfaction, retention, acquisition, market share etc.

Employee Reactions Employees are capable of having an impact on productivity and customer satisfaction, especially in service business. Employee assessments made at multiple times and with relevant measures may allow better changes to take place. It should be analysed whether employees understand the expected contribution to be made to new organization; the view of employees towards various aspects of organisation and leadership; commitment to the newly formed organization; performance and productivity expected etc.

Successfully integrating two or more organizations after a merger requires many things, but above all, it requires strong effective leadership, a plan, and a commitment to ongoing evaluation and adaptation. It must be ensured that both the integration process and the programmatic work of the organization continue to move forward in tandem.

An integration plan is also essential. Leaders with experience in integrating two or more organizations emphasise the need for a plan than almost any other factor for success in integration. It was concluded in a series of interviews conducted with leaders who had been through a merger that a integration plan was a key factor for success.

Lastly, an organization and its leadership must be proactive in evaluating progress throughout the integration process.

A successful integration 'moulds' not only the various technical aspects of the businesses but also the different cultures. The best way to do so is to get people working together quickly to solve business problems and accomplish results that could not have been achieved before.

Thus, the aspect of post-merger reorganisation is not exhaustive and the parameters of the same would have to be established by the management of the companies, depending upon the organisational requirements, corporate policies and plans and the objectives of the merger etc. sought to be met.