



# **MERGER & ACQUISITION**

***GLOBAL PERSPECTIVE AND NEPALESE  
SCENARIO***

## Merger & Acquisition

Mergers and acquisitions (M&A), in a general term, refers to the consolidation of companies or assets. A merger means a combination of two companies to form a new company, whereas an acquisition is the purchase of one company by another in which no new company is formed. It is an important aspect of strategic management, which allows enterprises to grow, shrink, change the nature of business or improve the competitive position.

## Global Context

History of Merger and Acquisition dates back to 1708 AD when East India Company merged to form United Company of Merchants of England Trading to the East Indies.

Since then, merger and acquisition has come a long way and it has become one of the strategic tool for corporates for business expansion and maximization of shareholder's return. Globally, thousands of merger and acquisition transactions are reported annually.

As per Institute of Merger, Acquisition and Alliance (IMAA) companies, in 2016 announced over 49,078 transactions (11.54% above 2015) with a total value of more than 3.63 trillion USD (19.33% less than 2015). For 2017, number of M&A transactions are expected to be 47,279 (Value –3.35 trillion USD).

Further, in Asia- Pacific, around 15,327 mergers with value of 1,111 billion USD was reported during 2016. For 2017, number of M&A transactions are expected to be 14,215.

U.S. M&A made up nearly 50% of the total M&A deals.

Many worldwide surveys predict strong M&A environment across the board, in private and public businesses and in multiple industry sectors.

Many worldwide surveys predict strong M&A environment across the board, in private and public businesses and in multiple industry sectors.

## Nepalese Context

In Nepal, the history of merger dates back to late 80's when Eastern Electricity Corporation merged with Nepal Electricity Authority (NEA). However, merger and acquisition was not reported to be a regular strategic activity in Nepalese corporate sector, although there were some instances of merger and acquisition (including management takeover) in between.

Recently, the merger and acquisition activities have suddenly increased from 2011, especially in banking and financial service sector, after tighter capital adequacy and minimum capital requirement imposed by regulator, the Nepal Rastra Bank, clubbed with Central Bank's intention to reduce number of banks and financial institutions reflected in monetary policies and Merger and Acquisition Byelaws having provisions to facilitate Merger & Acquisition (M&A) and indirect provision of forceful merger.

As per available date, there has been substantial activities in the merger and acquisition of banks and financial institutions in last 3 years, mainly on account of increased minimum capital requirement imposed by Central Bank. Total 199 banks and financial institutions have been reduced to 82 banks and financial institutions as detailed below till December end 2017:

Particulars	Class of Institutions					Licensed Institutions (Post Merger)
	A	B	C	D	Total	
Licensed Institutions (Pre-Merger)	35	96	63	5	199	82
Licensed Institutions Reduced	4	55	54	4	117	
Licensed Institutions (Post Merger)	31	41	9	1	82	

We can expect many more mergers in Banking and Financial Service Sector Due to increased focus on Capital Adequacy Norms and Risk Mitigation.

With the regulatory requirement to increase capital in Insurance sector, there is a chance, though very slim, that there could be cases of M&A in Insurance Sector as well in coming times.

Expect many more mergers in Banking and Financial Service Sector Due to increased focus on Capital Requirement, Capital Adequacy Norms and Risk Mitigation.

## Regulatory Framework for Merger

Following are the prevailing laws/regulatory directives that guide merger and acquisition process in Nepal.

- i. Companies Act 2053 (Section 177)
- ii. Merger & Acquisition Guidelines 2073 issued by NRB
- iii. Bank and Financial Institutions Act (BAFIA) 2073

## Strategic Driver for Merger and Acquisition

As discussed earlier, merger and acquisition is one of the important strategic tools for today's leaders for business expansion and maximization of shareholder's return. As per different researches conducted worldwide, following are the strategic driver for merger and acquisition.

- Effecting organizational growth
- Increasing market share
- Gaining entry into new markets
- Obtaining products
- Keeping pace with change

Business Growth and  
Maximizing the  
Shareholder's Return is  
the Key

## M&A- Success Rate

According to recent Harvard Business Review report, the failure rate for mergers and acquisitions (M&A) is between 70 percent and 90 percent. That means more than 70% of merger and acquisition transactions fails to boost shareholder returns and achieve other intended strategic results.

In Nepal, as M&A in banking and financial service sector is relatively new phenomena and is, in a way, forced due to regulatory requirement, real effect of M&A in in terms of return to shareholder is still to be judged.

## Why major M&A Fails

There could be many reason for failure of M&A ranging from mismanagement of risk, inappropriate pricing of deal, lack of strategic coherence, cultural integration issues, or management capacity. But mostly it has been seen that lack of understanding on part of leadership regarding the complications and complexities of the two companies coming together and the time that must be invested to form a working relationship.

## Pre-requisite for Success

Many studies have been conducted worldwide to identify the reasons why mergers and acquisitions fail to yield intended result. Though integration of any business/company is complex, and there are no automatic approaches to ensure success of integration, commonly following pre-requisite for success of merger and acquisition activities have been identified:

- A Clear Strategy
- Effective Project Management (Early and detailed planning, rigorous execution and continuous monitoring)
- Open communication between stakeholder groups (Third party mediation)
- Transparency
- Involvement of all areas of management including the leadership and dedicated resources)

Focus on effective integration of *People & Culture* and *Technological Integration*

As per Deloitte M&A Trends Report 2015 “Accurate target valuation and effective integration is key areas to ensure success of M&A activities”.

Based on various studies, it can be easily said that integration of ‘people and culture’ and ‘technology’ are key to success of any merger and acquisition activities.

## What can be done to make it right?

Clear cut strategy for integration, proper estimation of synergy effect from integration and effective integration focusing on size, culture, resources, financial strength and management complexity is important for successful merger and acquisition. Following can be considered as most important aspects that are important for successful merger.

- **Strategic Focus**

The one way to enhance an effectiveness of merger and acquisition transaction is to be strategically clear about the purpose of merger/acquisition, e.g. to boost company’s current performance or to reinvent the business model and redirect the company, and ensure that target selection is in line with strategy. Further, it should be ensured that strategic direction, organization, and process disciplines are properly followed during the whole merger/acquisition process.

- **Fair Target Valuation**

As discussed earlier, accurate target valuation is very important for effective merger and acquisition. Hence, adoption of business valuation techniques that recognize the business growth prospect and future earning capabilities of the target entities is important.

Merger & Acquisition is bound to fail if synergies that is expected from merger/acquisition is overestimated. So, clear and accurate estimation of synergies in terms of economies of scale and scope, best practice, the sharing of capabilities and opportunities and so on is key success of merger & acquisition.

In case of mergers of bank and financial institutions, though merger and acquisition guidelines have been issued by NRB, said guidelines is not clear on method of target valuation and in most of the cases target valuation is being done on 'Adjusted Net Asset Value' model which fails to recognize the business growth prospect and future earning capabilities of the target entities. So, this appears to be one of the area where regulator should look into to ensure accurate target valuation and fair business deal.

- **Focus on Cultural Integration**

Ensuring effective cultural integration, which broadly includes Human resource integration and creation of value of merged entity, is one of the most important aspects for successful merger. Leadership should be able to determine the culture to which merged entity should merge into and co-create a brand new culture from scratch. Experiences has suggested that picking one culture, from among merged entities, and merging cultures of all entities into the same as more likely to be successful.

## **What Next?**

As discussed earlier, there has been widespread merger and acquisition of banks and financial institutions in past 2-3 years, especially triggered by Central Bank's increased minimum capital requirement and it appears that banks/financial institutions have succeeded in meeting their instant objective of meeting minimum capital requirement. However, only time will tell whether such merger/acquisition will be able to deliver value to the stakeholders of bank's and financial institutions and support in overall strategic goal of risk management and sustainable business growth while supporting economic development of the country.

## **References**

- *The Big Idea: The New M&A Playbook: Clayton M. Christensen, Richard Alton, Curtis Rising, and Andrew Waldeck*
- *M&A: The One Thing You Need to Get Right: Roger L. Martin*
- *Institute of Merger, Acquisition and Alliance (IMAA)*
- *Harvard Business Review report, 2016*
- *Deloitte M&A Trends Report 2015*
- *U.S Executives on M&A: Full Speed Ahead in 2016: KPMG*
- *The Root Cause of Every Merger's Success or Failure: Culture; George Bradt, 2015*
- *Why so many mergers and acquisitions fail after the deal is closed: Gary Miller, 2014*
- *NRB Statistics*

**Disclaimer:** *The information contained herein has been derived from sources believed by the writer to be reliable. SAR Associates does not represent that such information is accurate or complete. Any opinions or estimates contained in this publication represent the judgment of writer at this time and are subject to change without notice. SAR Associates does not accept any responsibility or liability to any reader of this publication in respect of the information contained within it and will not be responsible for any decision taken based on matters contained herein. Readers of this publication are advised to seek their own professional advice before taking any decision.*