

Impact of Covid-19 on Mergers and Acquisitions

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Mergers And Acquisitions In Pandemic (Covid-19) Times: Challenges And Way Forward.

Merger & Acquisitions (M&A) is one of the better and sought after modes for expansion of business operations by a companies to either leverage the full potential of a specific line of business and / or to venture into newer and unexplored line of business.

In the pre-Covid era, M&A segment witnessed a considerable spike in the number of business deals that took place. Keeping this trend in mind, most experts believed that the year 2020 would end up as yet another strong year for M&A segment.

The outbreak of the global pandemic – Covid-19 has completely changed the dynamics of the global economy and has brought about major economic challenges for nations, companies and people all over the world.

The unknowns and the unpredictable nature of the Covid-19 outbreak makes it extremely difficult for the companies to evaluate the potential impact on their business prospects.

The world has been forced to go into lockdowns and confined social participation to encounter the corona virus crisis. As a result, there is a breakdown in the supply chain of most commodities, quantum of consumer consumption capacity and cash reserves posing a unprecedented economic challenge for all stakeholders of the entire ecosystem.

Matter of fact – the pandemic has jammed the normal life of all walks of people all over the world and has brought the general and economic progress of most companies to a grinding halt.

Currently and post Covid-19 crisis, quite a few companies may have to fight for survival and some of them may even have to stare at the prospect of business closure – This will correspondingly impact the M&A segment which is likely to witness a significant drop in business deals.

But as it is known and believed over time, necessity is the mother of invention and adversities bring about newer opportunities.

It is strongly believed that companies that face the survival challenge may end up collaborating with other companies via mutually beneficial business strategies to survive the unprecedented and unforeseen economic challenges.

The Covid-19 crisis is also believed to bring substantial amount of stressed assets – which will force financial institutions to leverage these stressed assets.

At the same time, those companies which have stronger cash reserves amidst and post crisis may find the time appropriate to acquire available stressed assets at a much more reasonable cost. It may be an opportune time for cash rich companies to evolve a more proactive approach to expand business by acquiring companies with stressed assets. The main challenge for these cash rich companies would be to tactfully identify potential business opportunities and associated risks (be it legal risks or otherwise).

The yard stick for a successful M&A would be to optimally explore the right business opportunity with an apt business strategy along with to mitigate the legal/business risks.

Post this corona crisis, the companies looking to acquirer other companies will have to place additional emphasis on key areas like due diligence, business valuation, business structure and legal documentation.

Due Diligence:

As the part of the effective due diligence process, the acquiring companies should carry deep evaluation of business impacting aspects such as:

- Assessment of revenue flow and business progress/performance.
- Material provisions of contracts with special emphasis on force majeure/related provisions.
- Legal/business risks of the target entity.
- Elements covered under insurance.

- Cyber security and risk assessment.
- Liability associated with employee welfare.
- Assessment of impact of pre-COVID EBITDA.

· Estimated time to recover back to normalcy from the impact of corona virus crisis.

Some challenges involved in the due diligence process could be:

- Choice of virtual and remote working as much as possible.
- Constraint on traveling arrangements / on site inspections / review.
- Challenges in procuring first hand information.

Aspects to be integrated into due diligence process:

- Adoption of virtual working style via usage of virtual interactions and virtual data rooms.
- Allocation of dedicated senior team for due diligence task.
- Management level assessment of challenges encountered in the business progress/performance.
- Adjustment of due diligence timelines.

Business Valuation

Acquirers may have to pay special consideration on the following prospects in the business valuation:

- Revenue assessment/projections during and post corona crisis.
- Economic burden in the form of debt obligations, deal specific expenses and one-time settlement of obligations.
- Economic assessment of the business vis a vis liquidity status.
- Comparative analysis of success/failure of similar M&A adventures, if available.

Challenges involved in the business valuation process:

- Economic uncertainty and vulnerability in the economic forecasts.
- Cloud over the credibility of economic projections due to lack of benchmarks to backup economic projections.

Economic precautions that may be followed in business valuation:

- Consideration may be adjustment based on the market reality and post-pandemic performance.

Legal / Regulatory Angle

Acquirers should focus on the following legal/regulatory aspects as well:

- Implication of the transaction structure on all the stakeholders involved from the tax and regulatory perspective.
- Likelihood of potential penalties/claims on the pretext of corona crisis.

Challenges:

- Exposure to unmeasured economic liabilities and risks due to corona crisis.

- Restricted financing deals.

Measures to mitigate economic risks:

- Consideration in cashless form – e.g., share swaps.
- Reduce tax liability by availing tax waivers/benefits/concessions (if available).
- Link the finance payment to the escrow/hold back module.

Legal Documentation:

Key pointers to be incorporated into the legal documentation:

- Reasonable timelines for securing approvals from government/regulatory authorities or third parties.
- Interim measures to mitigate the risks associated with the corona crisis.
- Using force majeure clauses to terminate some agreements which have material adverse impact on business.

Challenges in the legal documentation:

- Identification of material adverse impact events and course of action to be taken in the occurrence of such cases.
- Procurement of deal specific representations and warranties.

Legal provisions to counter these challenges:

- Reasonability with timelines
- Secure specific information rights till closure
- Incorporation of situation specific representations and warranties.
- Securing indemnity and risk mitigation



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