The secret to a successful M&A

Every Company, big or small, aspires to grow even bigger. Growth can have many facets to it. It can be in the form of adding new products, or customers or geographies which ultimately leads to increasing the top line or the bottom line. The big question then is How to Grow? Businesses generally have 2 options when it comes to growth – organic or inorganic. Each comes with its own sets of merits and demerits. The organic route is more tedious where you build brick by brick, ploughing back your accruals which takes time which in turn means you always carry the risk of missing the opportunity itself which is present today. On other hand, it is more solid and insulated from the challenges of cross organisational integration which inorganic expansion brings in. The inorganic route offers you a chance to expand your reach and resources dramatically in a much shorter time as compared to the organic trajectory. It does come with its own considerable set of risks and headaches, but for all its cons, more and more businesses today are inclined towards this option just because of one reason – 'time to market'.

Once a Company decides on the inorganic route, the next question arises – private equity or a strategic partner? A private equity player provides funding and strategic guidance, but a strategic partner in addition to also lends mentorship, access to new markets, to newer technologies and to their better developed networks.

Irrespective of which option you pick, one needs to get his own house in order before you invite others to stay in it. SMEs and family run businesses have a bigger challenge here as they are used to run their business in a 'certain way'. They are incentivised to save taxes by showing lower profits, but this is a double-edged sword. This hurts when an outside investor is assessing them as an investment option. Logic is simple, lower profits = lower valuations. When getting ready for a stake sale, it is imperative to get your books show the true picture in as transparent a manner as possible. This is easier said than done and SMEs can take professional help if required. Idea is to show the true income generating capability of the business on a standalone 'pro-forma' basis. Books may need to be adjusted for transactions like related party deals not on arm's length, prior period items, non-operating income and expenses and any other accounting adventures which are generally done to show lower profits. Another important financial tool to be developed and monitored is the MIS. How does management tracks day to day operations, which KPIs are regularly monitored, how they link up to financials and who all have access to it?

The one major worry that any investor whether PE or Strategic has when assessing an investment, is transparency. This is a problem that organisations of every size face. No one wants to pay for something and find out when it's too late that things are not as they seem. Therefore, a robust corporate governance system is so essential. You need to have strong yet scalable processes in place that ensures transparency yet allow for growth. Strong processes mean that the firm is not dependent on any single individual, that the managerial bandwidth is strong and most importantly that there is a succession plan in case things go awry.

Another very important part of the process is valuation. Valuing a business is not a science, it is an art. Just as every industry is different, so are the valuation methods needed for each industry. Oil and gas, industrials, healthcare, pharmaceuticals, infrastructure, ecommerce, education, all have different business drivers, different growth rates and different factors that impact their growth with differing intensities. One needs to clearly identify the key business drivers and make realistic projections for the next three to five years around that. A sound business plan will capture the future value of the business on which investors can further build on synergies. Do not try and do this yourself, hire an experienced external unbiased expert. Experienced valuations experts who do this for a living will be able to offer you a clear and standardised valuation of your firm. A professionally done valuation goes a long way to support a tough deal negotiation.

Any M&A decision is like deciding to marry and should not be taken lightly. One goes through a series of blind dates looking for someone who meets your requirements. Each side does its best to impress the other. If the first date goes well, you need to get to know the other side better, i.e. a due diligence on financials and business. Most deals either fall apart or get severely de-valued at the due diligence stage. Those that clear this stage are the ones that have their finances and books in order. Due diligence usually starts 6 months after the first meeting. Most SMEs are ill prepared to handle this process as they have never been exposed to it. Professionals can help to manage the whole process where they get you ready for the due diligence from Investors and help you answer tough questions from their advisors.

Once the due diligence is cleared, battle is half won. Last stage is the legal documentation and its negotiations. Few critical clauses which are to be negotiated are Indemnities, Affirmative and minority protection rights, Corporate governance, Future exist etc. A seasoned M&A lawyer can help you navigate this stage comfortably. From start to finish the entire process can take 6-9 months which of course depends on complexity of each transaction.

Cross border mergers and acquisitions involving Indian companies are on the rise and are expected to continue given the number of big ticket projects being referred to NCLT under the Insolvency and Bankruptcy Code and the various initiatives being taken by the Indian government. India is still a very attractive investment destination and mid-size Indian companies who are well prepared to invite foreign investors should take advantage of this opportunity. Most foreign investors are from the US, Europe or Japan and strong corporate governance is vital to them. These could be challenging for SMEs at first but the only mantra to overcome this and be successful is to be transparent and share a common vision of growth with them. Best is to always put yourself in their shoes and think what would you like to see if you were investing in someone else's business. Any long-term relationship is based on trust and respect for each other and M&A is no different.

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