The Coronavirus Crisis' Effect on Mergers and Acquisitions Activity

Dr. Maneesh Kumar[1], Rahul Pal[2]
[1]*Assistant Professor, Department of Commerce, Deen Dayal Upadhyaya Gorakhpur University, Gorakhpur*
[2]*Research Scholar, Department of Commerce, Deen Dayal Upadhyaya, Gorakhpur University, Gorakhpur*

***Abstract* - The majority of economic downturns have been caused by chronic inefficiencies. Mergers and acquisitions are considered popular ways to speed up the execution of a company's inorganic growth strategy. The Coronavirus crisis is, first and foremost, a health crisis. The disease's progression is likely to be the most crucial factor in deciding the duration of the decline and, as a result, the best M&A window. But this Coronavirus outbreak has put the global market disruption caused by the worldwide lockdown has not only forced business to reset but has also driven thousands of businesses into bankruptcy. To ensure market continuity, many would recommend restructuring. During the unprecedented Covid-19 crisis, the M&A industry saw a drop in deal value and volume, as well as delays in regulatory approvals, travel restrictions (for onsite Due Diligence), and acquisition funding delays. Deals are typically calculated based on the majority of turnover figures, which are difficult to predict in the current environment, causing target company valuations to impact negatively. M&A will enable corporations to gaze into a future filled with technology and structurally different business models as they prepare for the boom that will follow this downturn. This paper aim is challenges faced by M&A dealmakers due to the COVID-19 breakout and provide recommendations.**

***Index Terms* - Merger and Acquisition, Coronavirus, lockdown, Due diligence, Company Valuation.**

INTRODUCTION

Merger and Acquisitions (M&A) consider being an inorganic growth strategy in the world of corporate finance. This inorganic strategy differs from organic strategy, where business grows through investment evaluation techniques and amplified profits. The merger and acquisition process encompasses all of the steps involved in merging or purchasing a corporation from start to finish. M&A covers all tasks related to planning, analysis, due diligence, closure, and execution. M&A activity's primary driving force is to gain synergies. In this synergy, the combined value of two companies is more significant than two individual companies, i.e., 2+2 =5. These combining gains could be Financial, Revenue, and Cost synergies in M&A activity. M&A can occur through the acquisition of assets, the acquisition of common shares, the exchange of shares for assets, and the exchange of shares for shares. Mergers and acquisitions (M&As) are effective transition drivers and an important part of any corporate plan. Which is a well-known fact that as companies evolve, only the most creative and nimble would be able to succeed. As a result, opting for some M&A agreements is a critical strategic decision for a company. On a happier note, M&A is similar to an arranged marriage in that couples will take time to learn and mingle, but the majority of the time will yield good outcomes. The year 2020 has arisen as one of the drastic years in human history on the unprecedented contagious disease named the novel SARS-Cov-2 Coronavirus, also known as COVID-19. The epidemic of the coronavirus (COVID-19) will continue to have a substantial impact on mergers and acquisitions (M&A) throughout the world. Past economic crises, such as the dot-com bubble bust in 2000-2002 and the Great Recession of 2007-2009, have been survived and recovered by the M&A industry. Uncertainties in the business and capital markets, like in previous financial and economic crises, have already caused purchasers to postpone or cancel their purchase plans. But this time is different: the pandemic's influence is felt not just on the financial system as a whole, on seller valuations, and on buyers' desire to close deals quickly, but also on a slew of other M&A-related elements. Hundreds of thousands of companies have closed or dramatically shortened their activities in a brief amount of time. Millions of jobs have been laid off or furloughed, customer spending has been drastically decreased, supply chains have been a wreck, and demand for oil and other energy supplies has plunged. The decline in financial markets and the global economy, of course, has an effect on the M&A industry. Prior to the crisis, the worldwide number of mergers and acquisitions (M&A) transactions was also declining (and deal value held up only because of several megadeals). This pattern is predicted to persist, at least in the short future. The development of stock prices and risk, as measured by implied volatility, has traditionally been strongly linked to M&A activity.

In these blustery times coporations foremost aim is keeping their employees and business safe. Companies will be able to prioritise investment to develop the company portfolios, durability, and agility needed to accelerate sustainable growth in the future through learning from their recent results.While the pandemic remains the most serious external danger, the changing economic climate is a significant source of concern, and pre-pandemic threats have not vanished

M&A DEAL PROCESS

Merger and Acquisition deal is a multistage and complex process. This deal process may take several months or years to complete. Well precisely, these M&A deals are executed by investment banking and private equity firms. In M&A Activity, there are two sides Buyer (acquirer) and seller (Acquiree) firm and involve transaction advisory firms, i.e., Buy and Sell-side. Here Buy-side refers to Investment banking & Private equity firms working on the buy-side, which entails collaborating with customers and identifying ways to purchase other companies. On the other hand, Sell-side refers to working with sellers looking for a buyer for a client's company.

The following are the steps in a standard M&A deal:

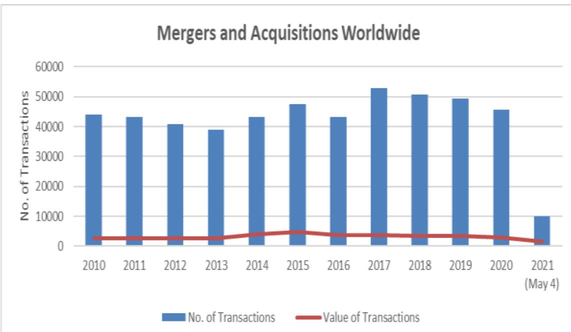
1. **Framing an Acquisition Plan -:** A successful acquisition strategy is based around the acquirer providing a solid understanding of what they hope to gain from the acquisition and their business intent for purchasing the target organization (e.g., expand product lines or gain access to new markets).
2. **Develop M&A search criteria –** Determining the most important criteria for identifying possible target firms (e.g., profit margins, geographic location, or customer base).
3. **Check for and evaluate potential acquisition targets –** The acquirer searches for and evaluates potential acquisition targets using the search criteria they've developed.
4. **Check for and evaluate potential acquisition targets –** The acquirer searches for and evaluates potential acquisition targets using the search criteria they've developed.
5. **Performing a valuation assessment –** Firstly, initial meeting and communications go well. Acquirer requests that the target entity include important details (current financials, etc.) that would enable the acquirer to better assess the target, both as a standalone company and as a potential acquisition target.
6. **Negotiations –** The acquirer should provide enough knowledge to create a fair bid by developing multiple value models for the target entity. Following the presentation of the original offer, the two companies will further discuss the terms.
7. **Due diligence in M&A –** Due diligence is a thorough review and analysis of every aspect of the target company's activities, including financial indicators, assets and liabilities, clients, human capital, and so on. It helps to validate or modify the acquirer's appraisal of the target company's worth by doing a rigorous examination and analysis of every aspect of the target company's operations, including financial metrics, assets and liabilities, customers, human resources, and so on.
8. **Purchase and selling agreement –** Assuming that due diligence has been completed without significant issues or questions, the next step is to execute a definitive contract for sale. The parties decide about the form of a purchase transaction, whether it is an inventory or a stock purchase.
9. **The acquisition's financing plan –** Of necessity, the acquirer would have looked at funding options for the transaction before signing the purchase and sale agreement. Still, the financing specifics usually fall together after the purchase and sale agreement is signed.

10. **Closing and integration of the transaction –** The acquisition is completed, and the aim and acquirer management teams collaborate on the merger process.

IMPACT OF COVID-19 ON M&A ACTIVITY

Deal Size

In 2020, the year-over-year change in deal volume was around 7.5 percent, while the overall value of deals was down 16 percent [2]. PwC's insights into global M&A industry trends, as shown in Figure 3, reveal that, despite a significant drop in the first half of 2020, worldwide transaction value and volume grew by 94 percent and 18 percent, respectively, which were both higher than the last two quarters of 2019. In 2020, there were 56 megadeals in the previous two quarters, compared to 27 megadeals in 2019.



Source-: IMAA Analysis (Figure 1)

Impact on M&A deal Activity-: On the advent of this COVID-19, contagion disease merger and acquisition activity has dropped globally during the March – April 2020 period. Companies that would otherwise be strategic investors have been compelled to refocus on the companies' health and focus later on acquisition growth strategies. Sponsors of private equity funds have been devoting a growing amount of time to efforts on saving their existing portfolios. Many new sell-side tasks are on hold, according to investment bankers, before things settle down.

Impact on M&A transactions timings and delays: Due to this pandemic crisis, deal deadlines are likely to be significantly expanded with all current M&A transactions that survive the pandemic and new deals entered into after the pandemic. Also, every stage of a standard deal would usually take longer, including formal negotiations between the parties, the negotiation of a letter of intent or term sheet, the negotiation of a final merger agreement, and the pre-closing time. A number of pandemic-related causes will cause these delays, including the following:

1. Negotiations would take longer: the widely-old saying of “getting everybody in the room” to compromise on an agreement is currently not feasible.
2. Due to travel restrictions where complete lockdown is imposed, due diligence will take longer, as there will be new M&A due diligence questions to fix.
3. Consents from third parties (landlords, clients, and intellectual property licensors, for example) can take longer to secure.
4. There will be a pause in securing any antitrust or other regulatory approvals that are needed.
5. In this setting, buyers will be concerned about their ability to value a seller accurately. Comparable transactions, including those concluded recently, would almost certainly no longer be relevant.
6. Due to the unsettled state of debt markets and available liquidity, borrowers that need funding will face delays, and M&A lenders can demand closing conditions that are much more restrictive than those sought by buyers, putting both buyers and sellers in danger.

Valuation -: Buyers will be able to renegotiate sales prices depending on the effect and danger of Covid-19 on the target's company. Sellers will try to characterize impacts as seasonal or sector-wide rather than unique to the goal. Sellers choose locked-box sales pricing models because they transfer liability to the customer between the signing and closure of offers.

The influence on the letter of intent -: As we expect buyers and sellers to avoid entering into (or even negotiating) a conventional letter of intent in light of the coronavirus pandemic. Since the pandemic raises fresh due diligence problems, buyers would feel justified in pursuing more extended exclusivity periods than in the past. Thoughtful sellers will try to use whatever negotiating power they have to overcome closing risk and assurance. The duration of this gradual due diligence process would be determined by the seller's conditions as well as the parties' relative negotiating strength.

Force majeure -: One of the top priorities for many companies dealing with the Covid-19 pandemic would be to suspend or be excused from contractual commitments. To determine if a force majeure clause has been activated, a thorough and deliberate analysis of the force majeure clause's legal language, as well as consideration of the circumstances, is required.

Though the word "Covid-19" may not feature in current agreements, the force majeure clause may contain words like "act of God," "conduct taken by a government or public body," "epidemic," or other terms of the same kind (s). This can be determined by the clause's exact wording and can result in a disagreement between the parties. Courts frequently read these clauses narrowly (i.e., if there is any doubt, the section is unlikely to apply).

Renegotiations based on force majeure principles can be considered, but in most European jurisdictions, they are impossible to proceed in standard terms.

Impact on Debt Financing for Acquisitions: Availability and Terms -: Historically, a large percentage of M&A transactions, especially in the private equity sector, has been partially funded by debt. Will the amount of debt available be reduced from what has been the norm in recent years? Can "reverse borrowing costs" in private-sector deals rise to mitigate their financial exposure? What kind of extra due diligence would a lender demand? Does a lender agree to adhere their closure conditions to the merger agreement's closing conditions, or will they demand more restrictive terms?

Impact on Indemnity, Representation or Warranties -: With the outbreak of this pandemic, it's likely that any of the previously mentioned R&W will no longer be valid and genuine. And if the negotiating authority is not always in one's favor, it is important to accept any of the above-mentioned points to finish on a solid footing. Furthermore, consider the case of 'Insurance,' a significant deal that is supposed to deliver if things go wrong. Even though certain companies promise to protect us during the period of a protected vulnerability, in violation of R&W, insurers have declared the possibility of exclusion to the cover advanced because of the unpredictability of COVID-19 and the massive outbreak that has been predicted across countries, markets, and businesses, insurers have included Covid-19 exceptions throughout their plans

The majority of the exclusions refer to any failure that could be related to the current Covid-19 pandemic. After negotiation, the scope of such exclusions could be limited, excluding coverage of only precisely centralized R&W based on the planned company's organizational profile.

Impact on Material Adverse Change / Material Adverse Effect (MAC/MAE) -: This provision reaffirms either party's ability to call off the deal in the case of an incident that has a significant negative impact on the occurrence's economic viability. As a result, it's critical to rethink MAC's concept to see if it's broad enough to account for the effects of a pandemic on depictions.

Impact on Due Diligence considerations -: We can see a greater emphasis on warranties and due diligence exercises based solely on content problems (as such "warning sign" reports) where due diligence timeframes are constrained. Buyers' dependence on vendor due diligence may also improve. Financial due diligence is being scrutinized more closely to see how the target company is going to survive in the present setting. During the due diligence period, both the seller and the buyer would understand the effect of Covid-19's continued spread on a target company's activities. In addition to the normal spectrum, special attention should be paid to the following:

Legal -:

- assess solvency and liquidity, particularly where the target is in an affected industry, such as hospitality, travel, tourism, or retail, and possible insolvency risks;
- check if the target can lower its rent based on those typical provisions under its lease agreement in case of a Covid-19 crisis;
- evaluate the sales effect of the Covid-19 crisis and whether to resume purchase price negotiations;

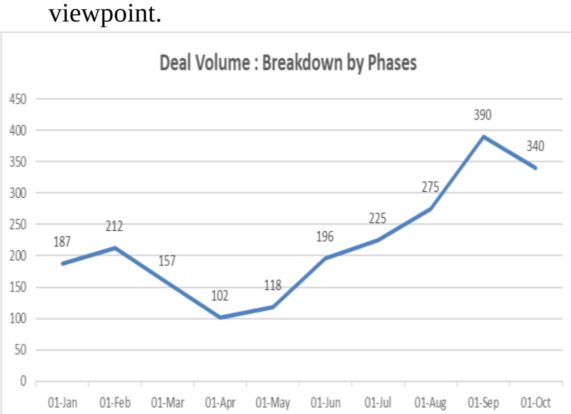
Financial -:

- carry out financial due diligence on the consequences of Covid-19 (cash flow/liquidity, receivables check, special arrangements for uncertain obligations, current trading, and so on);

- assess emergency regulations affecting the target, including if the target benefits from Covid-19 emergency measures such as emergency lending schemes and how efficient the pay-out mechanism is, in order to ensure sufficient liquidity or an adequate pay-out mechanism;
- investigate if the target's financing is sound or whether finance agreements are subject to (Covid-19-related) force majeure or termination clauses;

OPERATIONAL

- outline due diligence logistics, as increased due diligence time would likely be required due to: challenges in creating and populating a data room, so employees do not have full access to all files from home; inability to have the target company's supply chain, IT systems, and general robustness operate sustainably under Covid-19 circumstances;
- Perform due diligence on the buyer's funding, and whether it is sound or subject to (Covid-19-related) force majeure, from the seller's viewpoint.



Source: Data collected from Delloitte (Figure 2)

As seen in Figure 2, as of mid-February 2020, when the World Health Organization announced a global outbreak, the global number of M&A agreements had dropped by almost half. The unpredictability of the business climate, which includes stay-at-home orders, competition for new government regulations, and uncertain scale estimates.

This sharp downward slope [3] was induced by the COVID-19 virus. The gradual relaxation of lockdown restrictions, as well as vaccination announcements, propelled M&A discussions in the months that followed. As a result, between January 2020 and October 2020, the total value of declared agreements was USD 2.2 trillion [4].

SUGGESTIONS

Mergers and Acquisitions are considered as the core of the corporate realm, the mechanism by which the private sector forms and reshapes itself in response to shifting market conditions. As a result of this COVID-19 pandemic, M&A activity bids and deals have witnessed a deep slump. Despite continued concerns about the COVID-19 virus and its new strains, it is now evident (in 2021) that the M&A market experienced a V-shaped recovery, despite long-term speculations about the form of the recovery. In comparison to the 2008 economic collapse, when markets were devoid of liquidity, we can anticipate the M&A market to maintain its momentum in 2021, as debt and equity financing is easily available and low-interest rates exist throughout the world.

Here are some suggestions -:

1. Where deals are being finalized and being stuck due to this pandemic at a lower valuation, In such a situation where management teams involved in M&A Activity in this crisis are facing with decreasing of sales and cash flow and inadequate liquidity as it affects their business it would be better for managers to re-boot their M&A activity as soon as this contagious disease comes under control.
2. Here acquirer can follow the "patient active waiting" approach, in which the target is established, but the acquirer waits, which is a second option. If there is no real need to act immediately, even if confusion means a risk, this may be a good option.
3. Obviously, the acquirer would require reasonable reasons for its belief, which may include exclusive access to knowledge. The first is that competing companies are unaware of the move, and the second is that the acquirer has a thorough knowledge of the target company's activities.
4. As we know that in every M&A deal, Due Diligence is the core element in the deal process, and due to this pandemic which resulted in travel restrictions for management involve in M&A deals, An acquirer's failure to meet face-to-face

would not prevent them from reactivating a previous contract that failed at a critical point and should be completed a second time. Here acquirer knows the seller from previous meetings, and activity can be restarted over video and audio calls.

5. Earn-outs and indemnities will help close valuation holes caused by existing financial difficulties and unpredictable future opportunities. Earn-outs link the final selling price to the company's anticipated results. The acquirer will put a portion of the buying price into an escrow account using indemnity.
6. In this COVID-19 crisis, in order to get out from travel constraints now, there is time to undertake inventive due diligence like Inventory reviews can be done via video tours and drones, legal and accounting documents can be examined in virtual data centers, and personnel can be assessed with video links.
7. From this pandemic it is witness that many businesses have been operating in security mode, rapidly pivoting activities or transitioning to a truly remote and interactive world while navigating specific strategic, commercial, and organisational challenges. Technology based driven business have earned good amount of revenues. It would be plausible for acquirer to invest in technology driven with digital capabilities would be better investment avenues.

CONCLUSION

The M&A market is experiencing a wave of cautious optimism in 2021. M&A can support shifting business strategies to boost development and scope of enterprises in the short and medium term, with a shift in priority by corporations in response to social evolution. A seller's market will dominate due to an excess of debt and equity funding. Despite the fact that sales and earnings have suffered as a result of the pandemic, businesses are pleased with their success during the crisis and understand the need to prepare for the recovery. The majority of executives reviewed their entire strategy and portfolio, concentrating on customer-centric digital and technological strengths. As businesses seek to drive growth in the post-pandemic environment, mergers and acquisitions would be a favoured strategic choice. The distinction between winning and losing would be a strategy that can be planned and delivered for the post-pandemic modern world. This is a chance to reframe, reimagine, and rebuild, and investments in digital and technology would be a major enabler. Finally, executives expect a whole new competitive, economic, geographical, and social climate. Companies are now planning not only to rebuild results but also to reframe their futures for a better post-pandemic environment in the aftermath of the COVID-19 disaster. In the near and medium term, however, it is critical for buyers, sellers, and even investment bankers to strengthen their resistance against external threats like the COVID-19 virus. Most significantly, the pandemic has taught us that technological transformation can no longer be left on the back burner; rather, it must become a top priority. Most significantly, the M&A industry should be extra cautious when it comes to legislative scrutiny and environmental, social, and governance (ESG) issues.

REFERENCES

[1] LIN, L., Lee, C. F., & Kuo, H. C. (2013). Merger and acquisition: Definitions, motives, and market responses. Encyclopedia of finance, 541.

[2] IMAA.M&A by Industries. Institute for Mergers, Acquisitions and Alliances (IMAA). 2020. Available online: https://imaainstitute.org/m-and-a-by-industries/(accessed on 30 June 2021).

[3] Jacobs, B. COVID-19 Uncertainties Slam Brakes on M&A Activity. Rochester Bus. J. Available online: https://rbj.net/2020/04/07/covid-19-uncertainties-slam-brakes-on-ma activity/ (accessed on 7 April 2021).

[4] Macmillan, I.; Purowitz, M. M&A and COVID-19: Charting New Horizons. Deloitte. Available online: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/AboutDeloitte/COVID-19/gx-COVID-19-Mergers-Acquisitions-Charting-New-Horizons.pdf (accessed on 8 June 2021).

[5] 5.https://corporatefinanceinstitute.com/resources/knowledge/deals/mergers-acquisitions-ma-process/

[6] http://www.businessworld.in/article/Impact-of-COVID-19-on-Mergers-and-Acquisitions/21-07-2020-299574/

[7] https://hbr.org/2020/06/what-ma-looks-like-during-the-pandemic

[8] https://www.internationaltaxreview.com/article/b1q8zg4dh6ck6z/how-covid19-has-impacted-global-mampa-activity
[9] https://www.london.edu/think/mergers-and-acquisitions-beyond-the-covid-19-freeze
[10] https://www.ey.com/en_in/ccb/mergers-acquisitions-strategy-survey-summary
[11] https://www.bcg.com/publications/2020/covid-impact-global-mergers-and-acquisitions
[12] https://www.bcg.com/publications/2020/covid-impact-global-mergers-and-acquisitions