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Impact of Covid-19 on Mergers and Acquisitions

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ABSTRACT

The pandemic has not only affected public wellbeing but also had a material impact on global economy. Businesses have shut down, thousands of workers have been laid off, supply chains have been disrupted, and consumer spending has plummeted. Companies had put the M&A deals on hold and set their priorities only on keeping the businesses running amid the pandemic. Nation-wide lockdowns and travel restrictions have hindered the process of due diligence, resulting in deals being cancelled or postponed. In this article, we will discuss how the corona virus crisis has impacted the M&A deal-making and how buyers and sellers can each adjust to the changed circumstances to minimize their exposure to the risks associated with the pandemic.

I. INTRODUCTION

The process of Mergers & Acquisitions is extensively used in today's corporate world for growth and restructuring of business organizations. M&A activity in India had been largely resilient in the period 2015-19. There was a surge in M&A activities due to faith created in the investor community, new bankruptcy law, and faster approvals as part of Ease of Doing Business campaign etc. However, the Covid-19 outbreak has disrupted the M&A landscape significantly and increased the challenges for companies around the globe. Businesses had to make a difficult choice between survival and growth. Several M&A deals have been deferred including the privatization of Air India and BPCL.

II. IMPACT OF COVID ON M&A:

During the year 2020, M&A activities declined both in value (down 15%) and volume (down 11%) as compared to the previous year. By region, the America was down 25%, the sharpest regional decline, and the Asia Pacific region suffered the lowest regional decline at 4%[2]. In India, in H1, 2020, M&A deals declined to a 3-year low of USD 38.1 billion, a fall of 14.1 per cent as compared to H1, 2019. When Facebook pumped in USD 5.7 billion to acquire

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[2] Global M&A Report 2021, Bain & Co.

stake in Jio Platforms, it was touted as the biggest deal of H1, 2020 in India. However, the overall sentiment remained dismal in 2020 as many deals were deferred. While inbound M&A deals were at its highest since 2013, outbound activity declined by 13%.

While the measures introduced by Central government have given a fillip to the economic activity and foreign investment, some of its regulatory actions during the pandemic have slowed down M&A deals. In order to prevent opportunistic acquisition of Indian companies during the crisis, government had issued Press Note 3, restricting investment from countries that share land borders with India- significantly China[3]. This had a chilling effect on M&A from these jurisdictions. The government passed another order under IT Act 2000, restricting several apps which were allegedly engaged in activities prejudicial to sovereignty and security of India. The banning of several of these apps, along with the impact of Press Note 3, caused some delays and concerns for foreign investment into India

The impact of pandemic has been on a multitude of other factors affecting M&A deals. These include deal terms themselves, new due diligence issues that have arisen, the manner in which due diligence is conducted, the availability, pricing and other terms of deal financing, and the time it will take to obtain necessary regulatory and other third-party approvals for transaction[4]. Lockdown restrictions have also resulted in physical meetings and on-site inspections disappearing. Moreover, the cross border investments have been affected too due to border restrictions. Despite this, the new normal has also brought up new opportunities. Technology-based startups, which were adversely affected during this pandemic, present very good opportunities as acquisition targets by the existing bigger businesses. While some deals are being delayed or cancelled, some have been placed on agenda. These include businesses that have adapted well to changing consumer demands during the outbreak, as well as those who have become distressed because of the outbreak.

With time, there has been a significant uptake in activity as businesses have regained confidence and adapted to new normal. The second covid wave does not seem to have disrupted M&A and investor interest, with a 44% increase in deal values and 21% increase in volumes, compared to corresponding period last year[5]. While uncertainties about the global economy still remain and amidst the threat of a possible third wave, companies should prepare to strengthen their positions for survival and success in the new normal. The terms in the deals have adjusted to the environment and have used techniques to change the manner in

[3] Notification SO 1278 (E) dated 22 April 2020.
[4] "Impact of Coronavirus crisis on Mergers and Acquisitions", Forbes.
[5] Over $8bn M&A deals struck in May, Times of India, June 10, 2021.

which M&A transactions are developed and negotiated.

III. DEAL-MAKING IN THE NEW NORMAL:

Some of the considerations that deal makers have to keep in mind while executing M&A deals in the post pandemic scenario are:

1. **Material Adverse Effect (MAE) Clauses**: M&A Agreements typically include MAE clause, according to which a buyer may refuse to close the transaction, if between signing and closing, the seller has suffered a significant downturn which has threatened its overall earning potential. These clauses have always been heavily negotiated, as they give buyer a walk-away right. In the present times, buyers would insist on including effects of Covid-19 in the agreement (For eg: Possible third wave, lockdowns etc), but sellers would be keen to expressly exclude this. This will require longer negotiations and creative drafting by lawyers to prevent any ambiguity.

2. **Force Majeure**: This means an unanticipated situation, outside the control of parties that keeps them from executing the contract. In the light of Covid-19 pandemic, parties are likely to include epidemic/pandemic or government induced lockdowns in the Force Majeure clause. It is important to objectively stipulate the criteria to avoid any disputes.

3. **Pricing methods/ Deferred Payments**: Over the years, the Locked-Box deal mechanism has become popular in India. Under this, the purchase price of the target company is fixed at the time of signing and there can be no post-closing price adjustment. However, the buyers may now prefer determining purchase price by Post closing price adjustments, as the uncertainty caused by pandemic has made valuation of businesses difficult. Post closing Price adjustments are increases or reductions to purchase price to account for changes in the target company's financial condition between signing and closing. Locked box mechanism is seller friendly as it provides price certainty. In the post pandemic times, buyers are likely to defer payment of a portion of the deal amount linked to future performance of the target business. While sellers would prefer locked box approach, but any fixed price deal in these times may result in comparatively lower acquisition price.

4. **Representation and Warranties**: Buyers would assess the potential risk to seller's business from covid-19 crisis and seek detailed representations and warranties with respect to the effect of pandemic on seller's business/workforce/inventory, business closures etc. The purpose of such representations and warranties is to give buyers a walk-away option in case of breach of such warranties. Sellers, in turn, would appropriately qualify these warranties using materiality qualifiers to limit the potential walk away right of the buyers.

IV. CONCLUSION

Investment prospects are likely to increase on the back of an expansive nationwide vaccination programme and support from government. With a focus on building the domestic supply chain and to make India an export economy and reduce its dependence on imports, deal-making activity is expected to pick up. Sectors such as health-tech and fin-tech present tremendous potential and are likely to see an increased interest in them. The key to successful deal making during these unique times is to focus on due diligence and creative drafting to protect the interest of the parties involved in such deals.

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