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Cross-Border Mergers and Acquisitions: Legal and Regulatory Challenges

ABSTRACT:

Throughout history, Mergers and Acquisitions transactions—whether internal or external—have functioned as tactical instruments to attain expansion, gain a competitive edge, and generate money for investors. In contrast to establishing wholly-owned subsidiaries in foreign markets, multinational corporations are now more interested in engaging in cross-border mergers and acquisitions deals. Examining the scenario for the purchase and sale of enterprises reveals an unavoidable fact, notwithstanding the huge volume of activity in cross-border mergers. Cross-border transactions are inherently dangerous due to the difficulties of communicating across great distances, blending cultures, conflicts brought on by disparate business practices, and even basic differences in managing styles.

The paper therefore continues with a detailed discussion of the causes behind the problems that businesses encounter during cross-border mergers and acquisitions transactions as well as the reasons why these problems arise. The paper continues by outlining some suggestions and strategies for greatly reducing these difficulties on a broad scale when doing cross-border mergers and acquisitions.

Key Words- Mergers and Acquisitions (M&A), Cross-Border, Challenges, Transactions

INTRODUCTION:

In order to effectively navigate the obstacles presented by globalization, corporations have turned to mergers and acquisitions as an essential means of corporate reorganization. Acquisitions and mergers are powerful instruments for every business; they promote expansion and raise stockholder value.

Companies can increase their prospects and grow globally through cross-border acquisitions. The current mergers and acquisitions wave is notable for having a high volume of cross-border deals. These kinds of transactions will definitely face a lot of difficulties because of the global financial crisis. Furthermore, dealmaking has been greatly impacted by growing regulation, such as national foreign investment prohibitions and privacy regulations. In order to successfully accomplish cross-border mergers and acquisitions, companies today must manage both the business obstacles and the increasingly complex regulatory environment. Businesses primarily only engage in cross-border mergers and acquisitions deals when there is a significant chance of financial gain from the particular target company.

When doing mergers or acquisitions, there are numerous approaches and techniques to gain control of a private or public company. When carrying out a cross-border merger and acquisition, it is necessary to take into account legal factors such a due diligence evaluation, negotiation, valuation, evaluating the parties' obligations, scenarios and structure for contract termination, internal and external approvals, etc. The procedure is nearly the same as a domestic one, but a cross-border merger and acquisition requires additional steps.

Due to differences in language, behavior, and managerial corporate governance, the integration of the two businesses may, nevertheless, cause difficulties for managers, supervisors, and employees. Their final ambitions would be delayed and the merger and acquisition procedure would become more difficult. In order to prevent any such complications, any discrepancies that may occur between the organizations must be clarified for both parties.[1]

BACKGROUND OF MERGERS AND ACQUISITIONS:

Mergers and Acquisitions have been prevalent in developed economies for a long time. Increasing competition in the international business sphere contributed significantly to its widespread application since it began making its presence felt in the latter part of the 1800s. Globally, it emerged as a natural process of business restructuring. The increasing number of cross-border transactions conducted by multinational companies (TNCs) shows how mergers and acquisitions are occurring across borders. There is no longer anything new or novel about it.

Mergers and acquisitions emerged as a phenomenon in the Indian sector in the late 1990s. In the past, government organizations or financial institutions in India handled mergers and acquisitions inside a controlled environment. Since 1991, India's industries have become more competitive due to heightened internal and international competition. As a result, businesses started restructuring their operations through mergers and acquisitions in the direction of their main lines of business in recent years.

WHAT IS CROSS-BORDER MERGERS AND ACQUISITIONS?

Cross-border mergers and acquisitions (M&A) are transactions in which two or more companies from different countries are involved. The operations and assets of two or more businesses that are based in two or more separate countries come together to establish a new legal entity in a cross-border merger. When local businesses transfer their assets and activities to foreign enterprises, they become affiliates of the latter. This is known as a cross-border purchase. The term "cross-border merger and acquisitions" refers to the merger or acquisition by foreign investors that results in the transfer of control and authority for running the combined or acquired business.

FACTORS THAT MOTIVATE CROSS-BORDER MERGERS AND ACQUISITIONS:

Businesses participate in cross-border M&A for a variety of reasons. A few of the most important justifications for cross-border M&A are listed below:

[1]Vanita Tripathi Ashu Lamba, (2015),"What drives cross-border mergers and acquisitions?", Journal of Strategy and Management, Vol. 8 Issu 4 pp. 384 - 414

Taking Over- Cross-border mergers and acquisitions refers to the acquisition of control by the acquirer over the target company. The main result of a merger or acquisition is a change in the target company's control. When two companies combine, their operations and assets are incorporated into the new company. After uniting with two other entities, this entity gains control as a single entity. When a company is bought out, ownership is changed from the target business to the buyer or a foreign corporation.

A domestic corporation places itself or its products on the global stage when it decides to join the foreign market. The target company typically becomes a subsidiary of the purchasing company when it is acquired. When one corporation gains control over another through an acquisition, the target company could still be in charge of running its own operations and services. This procedure is used to make sure that disagreements over opinions or cultural differences don't cause problems for the companies.[2]

Entering international markets- This outflow of people into global markets has helped to facilitate globalization. In comparison to similar transactions, cross-border mergers and acquisitions have less of an influence domestically even though they have a big impact on globalization. Businesses have advantages and competitive benefits in overseas markets when they expand into those regions. This plays a part in a crucial process that encourages businesses to join international marketplaces.

The choice of whether to establish a fresh greenfield venture or purchase an already-existing corporation must be taken when a business wants to access international markets.

Therefore, when businesses choose to join overseas markets, they need to implement a number of appropriate and significant methods. Because the implementation of such techniques and the entity's internationalization process are crucial to obtaining a number of advantages.

Access to intangible assets- The firm is encouraged to obtain access to certain intangible assets, such as goodwill, new technology, human resource knowledge, trademarks, patents, management procedures, etc., by virtue of the acquirer's acquisition of the target company. It is necessary to ascertain the value of such intangible assets.

If no other strategy is used to gain the assets, a corporation that wants to acquire certain assets from a target company may do so by entering into a merger or acquisition (M&A).

As a result, in order to fully benefit from ownership advantages and benefits, the assets must be integrated following a merger or purchase.

Market diversification and expansion- Whenever a company enters a new market, its growth into international markets can increase its profitability. To maximize the entity's benefits, the business can diversify its fields of business and products. Products must satisfy the needs of the new target market when a company enters these outside markets. Cross-border mergers and acquisitions may encounter legal problems if certain factors are overlooked.

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[2]Anna Olsson Fladby and Andrea Urban, "The Rationale Behind Cross-border Mergers & Acquisitions," 2014, available at: https://core.ac.uk/download/pdf/43556613.pdf (last visited on January 5, 2024)

To guarantee more advantages for the organization, the corporation might also diversify its operations and product lines. When a business enters these foreign markets, its products have to meet the demands of its new target market. They also need to provide their clients better, higher-quality goods and services. When the business wants to broaden its product line in overseas markets, these factors need to be taken into consideration.

A business can use merger and acquisition to broaden its product line and grow into foreign markets, both of which can provide it with a number of advantages. Mergers are typically executed when a company diversifies its product line to enable entry into new markets and future growth. Consequently, diversification and expansion aid in the execution of cross-border mergers and acquisitions.

Growth potential- A number of businesses make acquisitions to boost their growth rates in order to reach their growth potential. These purchases are made because, should the company start any new projects right away, it would not be able to maintain its current growth rate. This could involve building strong networking and management, raising brand awareness, etc. A company's ability to grow is crucial for generating value for its shareholders.

Products are growing, and sales of these products in new areas are evident. It increases productivity and makes it possible for the company to use its cash flow effectively.

Through mergers and acquisitions, businesses can quickly penetrate new markets. This guarantees that the business will establish and hold onto its place in the international market as well as generally grow and achieve growth potential in those markets. Consequently, one of the several reasons businesses engage in cross-border mergers and acquisitions is company expansion.[3]

Natural resource accessibility- Businesses that engage in cross-border mergers and acquisitions eventually grow into new markets. This facilitates their access to the resources and facilities located elsewhere. Many businesses expand into international markets through either brownfield investments or greenfield investments, which involve investing in an already-established business. When a greenfield investment is made, the acquirer gains the ability to create any kind of subsidiary it desires. On the other hand, some invest in brownfield sites because it could take longer to develop and build a greenfield site.

Through mergers and acquisitions, businesses can gain access to such nation's natural resources, assuring the efficient operation of their operations. For instance, in a nation like Russia or Iran, where oil and gas are plentiful, an oil and gas corporation may decide to combine with or buy an international business.

In addition to increased availability to natural resources, other trends include increased market accessibility, a general need for technologies, improved information flow, diversification, etc.

Mergers and Acquisitions for Cross Border Transactions Fall into Two Types Based on The Flow of Transactions:

[3] Bhumesh Verma, Mergers and Acquisitions, (Bloomsbury Publishing Pt. Ltd. New Delhi, 2019)

Cross-border transactions that entail the inward movement of capital from the selling of a domestic company to a foreign investor are known as inbound transactions. Ex: Foreign companies making investments in India.

Cross-border outbound Mergers and Acquisitions: This type of deal entails the transfer of funds abroad in order to acquire foreign businesses. Ex: An Indian company making outside investments. Despite these distinctions, the two types of mergers and acquisitions are closely related because they both entail sales and purchases as part of a larger transaction.

CROSS-BORDER MERGER AND ACQUISITION: RISK AND CHALLENGES

The fundamental dynamics of domestic and cross-border mergers and acquisitions are identical. Due to its prevalence, cross-border mergers and acquisitions presents some difficulties, including those related to taxation, law, and cultural nuances. Threatening the company's success is the possibility that the target audience's likes and preferences, business methods, and culture will differ dramatically from the companies. During a multinational merger or acquisition, the following difficulties may arise:[4]

Political Challenges-

Cross-border mergers and acquisitions are heavily influenced by politics, especially in industries with delicate political environments like defense and security. It is imperative to address the concerns of stakeholders, including employees, suppliers, and other interested parties within the target company's jurisdiction, once the merger intentions are made public. These stakeholders include federal, state, and municipal governments. Some situations can call for advance notification and consultation with the labor unions and other relevant parties. To reduce the possibility of political risks such as government meddling, it is imperative to identify and assess any likely or current political ramifications.[5]

Cultural Challenges-

Due to complex negotiations resulting from potential cultural differences, linguistic constraints, and disparate business processes, mergers have frequently failed for a variety of reasons. The geographical breadth of a cross-border transaction creates a series of obstacles. Intercultural conflict is a major reason why cross-border mergers and acquisitions fail. Therefore, firms should be aware of the potential and problems that come with the amalgamation process and prepare their staff for them, regardless of the motivation behind the alliance. Businesses need to invest the time and energy to understand the local workforce's demands and culture in order to overcome these obstacles. The secret to success will be to communicate and work tirelessly.

Legal Consideration-

[4] Lawrence Pines, "Mergers and Acquisitions," Nov. 15, 2019, available at: https://www.investopedia.com/articles/insights/061816/4-cases-when-ma-strategy-failed-acquirer-ebaybac.asp (last visited January 7, 2024)

[5] Katina Hristova, Cross-border M&A: Rewards, Risks and Integrated Transaction Management, Finance Monthly | Monthly Finance News Magazine (2020), (last visited January 10, 2024).

It is important to consider the difficulties merging organizations may encounter with regard to rules and legal compliance. In the event that the target country's legal system differs, this could raise operating expenses and lower profitability.

Because of different employment regulations and stricter work laws in the target country, it can be difficult to reconcile employment contracts. Investigating the employment regulation, antitrust statute, and other contractual duties to be addressed is therefore essential before examining it. Laws governing the transaction's closing as well as the process are essential.

Taxation and Accounting-

Like any strategic decisions, there are risks associated with rewards. Taxes carry a lot of risk because every nation has a unique tax structure. Although tax security may appear onerous, it can be costly (tax) to be caught off guard by tax regulations.

Tax concerns continue to be of utmost importance when arranging the deal. When doing cross-border mergers and acquisitions, one should be extremely aware of common hazards such local and federal tax rules, the target's financial data, and regulatory compliance. It makes sense to have a thorough understanding of the debt-to-equity ratio in transactions as it will impact the amount of taxes paid.

Due Diligence-

This is an essential part of Mergers and Acquisitions. Apart from the aforementioned legal, political, and regulatory issues, there exist currency risks associated with infrastructure and other local obstacles that require meticulous assessment. An mergers and acquisitions transaction's terms and conditions, structure, and deal price c[6]an all be changed by a due diligence procedure. Risks can be identified by giving a thorough overview of the planned transaction and emphasizing any potentially hazardous regions.

Cross-border transactions have increased significantly during the past few decades, despite certain difficulties. Even with a few economic downturns and unfavorable circumstances, international mergers and acquisitions deals kept growing. The worldwide sentiment surrounding mergers and acquisitions indicates a definite shift in focus towards cross-border mergers and acquisitions due to their many advantages over starting from scratch, which can be achieved at a far lower cost.

CASE STUDY: Jet-Etihad Cross Border M&A

In 2013, a cross-border merger and acquisition occurred between Etihad Airways and Jet Airways. For $379 million, Abu Dhabi, United Arab Emirates-based Etihad Airways purchased a 24% share in Indian airline Jet Airways. This transaction was noteworthy because, following the relaxation of India's regulations governing foreign direct investment (FDI) in the aviation industry, it was the first time a foreign airline had made an investment in an Indian airline.

[6] Rajat Sethi et al., Defining Control: A Study of the Jet-Etihad Case Defining Control: A Study of the Jet-Etihad Case DEFINING CONTROL: A STUDY OF THE JET-ETIHAD CASE, 27 National Law School of India Review.

Due to Jet Airway's access to Etihad Airways' extensive global network and resources, the merger was also viewed as a significant financial boost for the airline, which was having financial difficulties at the time. Rather than being a complete takeover, the agreement was set up as a strategic collaboration between the two airlines. As a result, Jet Airways kept its name, staff, and board of directors, while Etihad Airways was granted a board seat and certain governance privileges.

The agreement was not without controversy, though. The agreement drew criticism from certain Indian lawmakers and business analysts who said it would breach Indian aviation regulations and result in job losses in India. Pressure to reconsider its FDI policies in the aviation sector was also applied to the Indian government. Notwithstanding these reservations, Indian regulators approved and carried out the Etihad Airways-Jet Airways agreement. Following the agreement, Jet Airways did experience some financial growth as a result of Etihad Airways' investment, which also allowed the airline to enhance its services and broaden its customer base internationally.

However, due to escalating financial issues, such as unpaid bills and rising fuel prices, Jet Airways was forced to ground all of its aircraft and halt operations in 2019. Since then, the airline has been facing insolvency procedures, and its future is still unknown.

All things considered, the Etihad Airways-Jet Airways agreement provides as an illustration of the potential benefits and difficulties associated with international mergers and acquisitions, especially in the aviation industry. Such agreements may open doors to new markets and resources, but they may also come with concerns related to finances, politics, and regulations.

APPROACHES TO ELIMINATE THESE CHALLENGES:

The companies need to make sure that there is proper communication between the parties involved and that the public, employees, and authorities are all more involved in order to ensure that the issues are eradicated or greatly reduced. Every stage of the process needs to be recognized, evaluated, and any necessary adjustments need to be brought to light within the agreement. Businesses can establish a strong sense of trust with the target organization by going above and above in informing them about their operations. For this reason, if businesses want to close a contract, they must collaborate and work together with the target company.

First and foremost, in order to prevent legal issues, it is imperative that all contractual obligations essential to the deal's completion be met from the outset and that the laws of the host nation be respected. It is necessary to do due diligence and appropriate legal skills. However, if a corporation finds out throughout the evaluation process that there may be incompatibility, it must not proceed with the merger and acquisition.

It is necessary to reduce and manage political risks because they are inherent in a nation's economic worth and markets. In order to keep them informed about the plan and prevent them from putting pressure on foreign enterprises, businesses could speak with certain government bodies.

Another important factor that frequently contributes to miscommunication and annoyance between the parties is linguistic disparity. Notwithstanding language barriers, the parties must be more informed and communicative at every stage to prevent such obstacles. Along with spending a significant amount of time learning about the local way of life, they also need to make an effort to communicate effectively with the other side.[7]

Culture is so important to the cross-border mergers and acquisitions process. Businesses occasionally overlook the human or cultural side of their operations in favor of the financial and legal ramifications. Therefore, there needs to be a greater emphasis on the people and labor unions in order to address these cultural issues. A company may have trouble adjusting to the acquirer's culture or business climate if it has a complicated or inflexible operational structure. As a result, it's critical that businesses have a flexible operational and working structure so they can adjust to the social elements that vary depending on the market in addition to the culture.

The parties should expect a drawn-out process to ensure that the sale is completed in cases where the tax and legal systems of a certain nation are complicated. As previously stated, a nation's tax and legal systems might be complicated, so businesses need to follow and abide by the procedures that will enable them to seal the agreement.

The acquirer needs to be very aware of the staff and their communication issues in order to prevent a lack of coordination among the staff. The HR departments need to be urged by the acquirer to concentrate on staff retention. This is required because, even if the acquisition is successful in altering the company's management, it can have trouble altering the attitudes of the workforce. Employees must therefore receive a lot of attention as well.

Due diligence is the primary element of an merger and acquisition transaction. It's a legitimate inquiry that offers a comprehensive background of all potential risks and opportunities associated with the transaction. The purchaser needs to take advantage of this process in order to thoroughly inspect the target company and carry out necessary acquisition-related tasks. Despite being amicable, the other party must necessarily receive a thorough rundown of the Due Diligence procedure. In this procedure, an HR Due Diligence must be involved in addition to the background inquiry on the company. Due diligence is essential to avoiding the difficulties associated with cross-border mergers and acquisitions.

Cross-Border Merger and Acquisitions Trends in India: A characteristic of the current wave is their active involvement in overseas markets as buyers of companies in other countries, in addition to the mergers and acquisitions of Indian enterprises within the home market within India. In order to overcome the challenges posed by the new globalization pattern, which has expanded the integration of domestic and foreign markets, the business sector is reforming its operations through a variety of approaches. Deregulatory actions have led to an increasing number of government functions. Although companies have historically frequently used consolidation tactics, the present wave of mergers and acquisitions is notable for the high number of cross-border transactions. An increasing number of these kinds of agreements have been inked by Indian businesses in recent years, which is indicative of

[7] Cross Border Merger & Acquisition |M&A Trends & Infographic, EDUCBA (2014), (last visited January 22, 2024).

global consolidation. As a result, Indian businesses have emerged as global leaders in a number of industries.

CONCLUSION:

Companies can gain from cross-border mergers and acquisitions in a number of ways, including the opportunity to enter overseas markets. Even though it appears straightforward, there are a lot of variables that might cause problems and traps that must be avoided for everything to go as planned. For integration to be successful, the appropriate target must be found, the transactions must be carried out, and the combined companies must be successfully integrated. Thus, it can be said that the organizational and national cultural disparities that both organizations encounter are the main causes of the numerous difficulties that merger and acquisition encounters.

But if businesses put in a significant amount of time and effort to inform and communicate with all parties involved in every decision-making, then these risks can be reduced to a great degree. When a buyer thoroughly examines the internal operations of the target company, including its ownership, management, and holding structure, cross-border mergers and acquisitions can result in improved outcomes. Therefore, despite the dangers associated with a cross-border merger and acquisition, the transaction can be successful if all procedures are followed correctly and efficiently. Careful planning, time commitment, and a host of other considerations are essential to efficient and fruitful mergers and acquisitions deals. In light of all of this, cross-border transactions are becoming increasingly significant as companies adopt a global perspective in order to penetrate foreign markets and prosper.