Proceedings Report

Appreciating Mergers and Acquisition

22 June 2010

Venue: Rara Hall, Radisson Hotel
Speakers: Rameshore Prasad Khanal, Secretary, Ministry of Finance
Suman Rayamajhi, Co-founder, beed management pvt. ltd.
Siddhant Raj Pandey, CEO, Ace Development Bank
Moderator: Sujeev Shakya, Chairperson, Nepal Economic Forum

Nepal Economic Forum (NEF) and National Banking Training Institute (NBTI) joined hands to organize an interaction program on 22 June 2010 in an effort to get investors to appreciate and illustrate the wide possibilities of Mergers and Acquisition in Nepal's business scene. NEF and NBTI invited Mr. Rameshore Prasad Khanal, Secretary of Ministry of Finance and Mr. Suman Rayamajhi, Co-founder of beed management to share their perspective on the issue and Mr. Sujeev Shakya, Chairperson of NEF moderated the event.

The event commenced with the introduction of NBTI by Mr. Sanjib Subba, CEO of NBTI, the national apex banking and finance academy which delivers quality training and academic programs related with financial institutions in the region. He emphasized on the need of institutions like NBTI that can contribute in developing human capital for M&A procedures in Nepal and introduced the panel for the event. Mr. Sujeev Shakya briefly spoke about nefport's second issue as an effort to seal the vacuum of information deficiency in Nepal and followed up stating the main purpose of the event which was to urge the government to review and reform legislative issues in regard to M&A procedures.

The first speaker of the program, Mr. Rameshore Prasad Khanal, covered two main points on the government's role to advance the facilitation of M&A issues.

- **Lack of confidence in domestic institutions:** Nepal's financial market opened up for international investment on January 2010. Contrary to the anticipation of the Ministry of Finance (MoF), only one foreign bank has applied to start up banking business in Nepal, mainly due to the instable political and economic environment. If foreign banks do enter Nepal, MoF is concerned about the capacity of local banks to compete with its foreign counterparts. Hence, it is essential for local institutions to explore M&A options. The government is considering raising the capital requirement from Rs. 2 billion to Rs.5 billion. However, M&As would prove far more effective than the earlier solution as M&As will minimize costs and increase industrial capacity, thus being able to compete at international level. Mr. Khanal also highlighted that merging is a difficult task, especially to maintain the sentiment of shareholders, management committee, and employees. Furthermore, the current issues of liquidity crisis and unstable investment climate pose significant challenges for companies to expand. In such a case, M&As establish an ideal solution.

- **Regulation Revision:** The main regulation ruling the M&A process is the Income Tax Act 2058. Policies under the Act hinder the progress of M&A activities. Section 57 of the Act requires the new company formed as a result of the merger/acquisition to re-evaluate its Assets and Liabilities which highly impacts the balance sheet of the company. Another discouragement for companies to merge is the double taxation of retained earnings. While the MoF cannot soften the policies permanently, the MoF can prioritize certain sectors which can be exempted from Section 57. The government is currently reviewing possible ways to implement such concessions.

A brief Q&A/Comments session followed the Secretary's speech. A participant commented that there is a discrepancy in asset valuation process in the market right now and that the government should provide a guideline on how the valuation process should be conducted. In response to this, Mr. Khanal commented that a manual is being prepared by the MoF for the asset valuation. Another participant suggested that one way to promote M&As in Nepal would be to provide tax incentives to merged companies based on their ability to increase public access to finance.

The second speaker, Mr. Suman Rayamajhi, touched on the technical aspects of M&As. His presentation vividly brought out the basic steps a company should take to evaluate the option of M&A. Mr. Rayamajhi also outlined the various issues that are faced by the companies interested in M&As. His presentation covered the following subjects on M&A due process:

Mergers 101

Mr. Rayamajhi compared the M&A to the concept of marriage between two companies. He outlined the difference between a merger, when two companies combine through pooling interests and acquisition, when one company buys out the other and assumes control of the firm. He also touched on the two types of mergers – vertical and horizontal; vertical being merger between companies providing different products to produce one specified result and horizontal being merger of two or more companies with similar product lines. Mr. Rayamajhi emphasized that the main motive for M&A is to create additional value to shareholders. Apart from the value created, M&As helps companies to fulfill the regulatory frameworks, ensure that the merged company is able to maintain a competitive advantage, acquire unique resources from both sides, and create a bigger visibility.

Nepal Story

Only been a handful of mergers have taken place in the Nepali business scene. Some examples of mergers in Nepal are Laxmi Bank and HISEF, and National Finance and Narayani Finance. Currently, some finance companies are in the process of merging. Similarly, NB Bank was forced to take over NB Finance and Leasing Company.
On the acquisition front, Butwal Power Company acquired Khimti and Bhotekoshi Hydropower companies. Standard Chartered Bank acquired Grindlays Bank from the ANZ Group. The most recent story of acquisition in Nepal is Teliasonera, which acquired Spice Nepal to form NCell.

M&A Caution

Despite of the many advantages that M&As provide, the big failure rate of the process is a concern. As per a study by Wharton, Harvard, and Morgan Stanley, M&A has a failure rate of 50% to 70% with the biggest factor for the collapse being the inability to integrate the different cultures between the different companies. The other reasons for the failure of firms are identified as the inability to achieve shareholder value, the exit of star performer from the company, faulty due diligence, inadequate allocation of resources, and unrealistic expectations.

Legal and Tax Perspective

There are five legislative ruling the M&A procedure in Nepal. The first one is the Companies Act 2063, Section 177, which highlights the impediments posed against the growth of M&As in Nepal. The BAFI Act 2063 – Chapter 10 is similar to Companies Act under which directives are in the process of being established that restricts cross holdings of companies. The Insurance Act 2049 and the Silent Proposed Act are the other legal rulings on the subject matter. The Competition, Promotion, and Market Protection Act, 2063 prevents a company from creating a monopoly in the market which an M&A could most likely produce. Securities Act 2063 and Labor Act 2048 are other Acts that affect M&As in Nepal. The other legal aspects that impact M&A are Section 36 to 401, Section 47, and Section 57 of the Income Tax Act 2058 which outlines the applicability of taxes on the gains or losses derived as a result of the disposal of assets and liabilities.

Process

Mr. Rayamajhi briefly ran through the standard steps for a merger process which is as follows:

1. Initial Discussion and Synergy Exploration
2. Preliminary Valuation
3. Formation of Steering Committee and MoU signing
4. Steering Committee engages M&A advisor
5. DDR/Business Valuation & Swap Ratio
6. Comprehensive Assimilation Plan
7. Pre and Post Merger Budget
8. Merger Scheme prepared and filled with CRO
9. Market Announcement

A brief Q&A session followed the presentation of Mr. Suman Rayamajhi. One participant inquired on the cost of two banks merging to which Mr. Rayamajhi answered that the main chunk of the total cost would be on training human resource while the other major cost would be the advisory and integration costs.

The second comment was made by Mr. Sanjay from Kumari Bank where he stated that it is difficult to achieve organic growth in Nepal which is why many companies do not seek to merge with other companies.

Mr. Sujit Mundul highlighted that the most critical factor in making a merger or an acquisition successful is the correct integration and assimilation of business culture between the two companies. He admitted that M&As are highly risky having a low success rate of only 15% over the last seven years. Many companies are not able to control the lost of human capital which impacts the performance of the company. Hence, acquiring companies need to remember to allocate money to train its new staff to create a synergy between the old and the new culture.

Mr. Mundul also inquired if there were any restrictions on foreign bank using international accounting firms to acquire a local bank. Mr. Shakya stated that there should not be any problem and cited the example of Teliasonera, who recently used an international accounting firm in their recent acquisition of Spice Nepal.

Prior to the closing comments, Mr. Shakya briefly summarized the session. He emphasized that Section 57 needs a reform not only for the advancement of mergers in Nepal but also because there is a dire need for bigger companies to acquire smaller ones considering the current Nepali business scene. Mr. Shakya reiterated the importance of expansion of commercial banks. He suggested that the government raise the share cap to NRP 5 billion and companies should reach this target through M&As. The successes of M&As in India- NRIs are investing aggressively in Indian companies- for the past fifteen years is creating investor awareness in Nepal. Hence, if Nepal follows suit and make legislative changes to promote the entry of foreign companies to merge and acquire with local companies, the track can turn the opposite direction as well. Such legislative changes would also facilitate local companies in acquiring foreign companies which would put Nepal at a significant limelight.

Mr. Siddhant Raj Pandey, CEO of Ace Development Bank, wrapped up the session by bringing out the key issues that were raised during the session and also provided his own perspective. He reiterated the fact that there are major legislative issues and reform from government's side is direly needed to promote M&As in the domestic market. As a board member of NBTI, he also announced the institution's support for M&A by conducting training sessions for M&A recruitment.

Nepal Economic Forum (NEF) is an independent national organization committed to improving Nepal through engaging all sectors in a partnership to shape national agendas. Incorporated as a not-for-profit organization, NEF believes that economic progress and social development are mutually supportive of peace and prosperity. The NEF builds and energizes the leaders of today's Nepal to develop creative and synergetic strategies which, when undertaken, can directly translate into an improved Nepal. NEF also provides recommendations on policy reforms to the government and larger Nepali community to ensure a healthy business climate. Towards this goal, NEF is committed to providing a common platform to industry leaders to debate and address critical issues. (www.nepaleconomicforum.org)

National Banking Training Institute (NBTI) is national level apex banking and finance academy. It was established under the aegis of Nepal Bankers´ Association with support from Asian Development Bank. Apart from commercial banks, its promoters include Nepal Rastra Bank and Rural Microfinance Development Center (RMDC). NBTI aims to deliver quality training and academic programs related with financial institutions in the region. (www.nbti.com.np)

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