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Corporate Acquisition: The Nuances of Acquiring a Start-up

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ABSTRACT: *The paper attempts to evaluate the increasing trend in the corporate world to acquire the potential start-ups. The focus area of this paper is to explore the nuances behind the acquisitionsof the Indian start-up Flipkart by the American retail giant Walmart. The paper also entails a case study of this deal, and attempts to highlight the core issues raised by this acquisition. In addition, the paper also, briefly, throws light on the apprehension of the traditional Indianbusiness community, and the fear that the entire e-commerce segment in India will be dominated by Amazon and Walmart, the two American giants.*
KEYWORDS*: corporate strategy, alliance,start-up, unprecedented, e-commerce segment*

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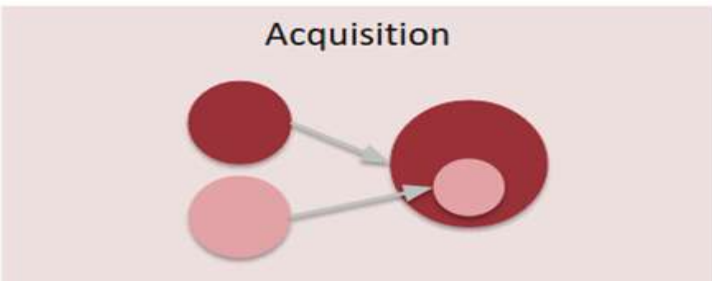
I think, it's a clash of cultures. You've an entrepreneur driven company taken over by a process-oriented firm, which makes money by saving pennies. Flipkart is an entrepreneurial-led company which spends enormously to gain market share. When one becomes the dominant partner, it will make sure that things are done in the way they would like it to be. ---T.V.Mohandas Pai, Manipal Global Chairman

I. INTRODUCTION

Mergers and Acquisitions is acorporate strategy often used to increase its size, talent pool, customer base and financial resources.More than mergers, large companies such as Google, Yahoo, or Microsoft are acquiring start-ups(Graham : 2005).In an acquisition, quite often, a bigger company purchases a smaller company, or a newly started company which appears to have lots of potentiality. The purchase may be a division of the target company or a large part of the target company's voting shares. (Krishnamurthy and Vishwanath : 2008)When one company takes over another company, and establishes itself as a new owner, or its major shareholder, it isknown as corporate acquisition.In many cases, a corporate may just purchase a controlling share of the acquired company's stock, giving it the ability to manage it from a distance but never fully integrating the two organizations. On the other hand, the acquired company may simply cease to exist, instead, becoming a single division of the acquiring company.(Taillard **:**2012)

Synergy

The major goal of combining two or more companies is to achieve synergy, which is often accomplished when the value of the combination of the two firms is superior to sum of the two standalone values. (Jensen and Rubock:1983). Synergy gains can be operational orfinancial. They may take the shape of cost reduction and perfection in operational efficiency, revenue improvement due to optimization of distribution networks e.g. cross selling, a boost in market power, abolition of competitors of a range of financial advantages like tax efficiency and leverage(Seth: 1190a1996). The new entity can achieve economy of scale, larger market share, better distribution network, control over staff redundancies, improved technology, talented workforce etc. The combined forces will have better financial resources to explore further growth and investment.



Source : https://burniegroup.com/mergers-and-acquisitions/

Despite having a host of possible benefits, acquisition may include huge risks associated with buying a company, e.g. higher legal costs and the possibility of a negative reaction from the business competitors. All in all, corporate acquisition is a risky affair.

In the book The Venture Capital Cycle (Gompers and Lerner :1999), it is estimated that nearly 25% of VC-backed start-ups are acquired by big corporate. At the same time,CB Insights data reveal that hundreds of start-ups are bought by Fortune 500 companies each year.Start-ups are 'incredibly exciting' because of the new technologies, products and business models they bring to the market. Start-ups attract the big companies because of the talented and innovative individuals who have made this happen. Start-ups are acquired for a number of reasons,whether it's to acquire the company's IP, their talent pool, their innovative product or for more advanced start-ups—their user base and revenue. It's imperative that the strategic objectives decided prior to initiating the process should be converted into quantifiable goals. The acquisition goals need to be clearly stated and a clear cut plan should be laid out to achieve these goals.

II. CASE STUDY

Walmart- Flipkart Partnership:
Transforming India's Retailing Landscape
Introduction

In May 2018, Arkansas-based, American behemoth Walmart announced that the company has acquired 77 percent stake in the Bangalore based tech-driven Indian start up Flipkart for USD 16 billion (Rs. 1.05 lakh crore), making the largest e-commerce deal in the country. The deal, so far, is the biggest for India's e-commerce sector, which Morgan Stanley estimates will grow close to an annual $200 billion in a decade.

Objectives

Walmart is attracted to the fast growing online Indian market space for a host of reasons. First, Walmart wanted to ensure its presence in the Indian market to cater to the needs and requirements of the 1.3 billion Indian people. The second important reason which ignited this mega acquisition was to counter the increasing market share of Amazon, another US based corporate, that has already carved its space in the Indian e-commerce market segment. From Flipkart's side, the main reason to sell out its majority stake is that, so far, it has remained only a Venture Capital company, and had its own financial limitations to meet its global ambitions. Both Flipkart and Walmart have their own unique strength. The fact of the matter is, Walmart needs the scale, digital infrastructure and the emotional connect Flipkart has established with its customers.The main reason for Walmart is that its organic growth in the e-commerce space would be very slow, and sizeable growth is possible only through corporate acquisition.

Amazon and Walmart

For both, Amazon and Walmart, Indian market and its huge consumer base, hold a great promise in their future business strategy.Satish Meena, a senior analyst at market research company, ForresterResearch, says that "Walmart realizes that India is a big opportunity and they need to be present now--- else, the catch up with Amazon is going to be difficult." Meena further added, "if we globally compare Walmart and Amazon, Walmart still has a huge lead over Amazon in terms of overall revenues -- $ 500 billion to $178 billion. But the e-sales of Walmart are a fraction of Amazon's. Walmart's US e-commerce was $11 billion for 2018 fiscal, and the retailer has been trying to bridge the gap." Vijay Govindarajan, Cove Distinguished Professor at Dartmouth University's Tuck School of Business claims that "India is too important a market for Walmart to ignore, especially since it has already saturated the US market…….It's only feasible entry into India is through Flipkart,"

Undoubtedly, Walmart is a huge retail giant and stands far ahead than Amazon in its total annual revenue. Yet, Walmart doesn't have a substantial presence in the online segment. However, Walmartknows that future belongs to digital marketing, and somehow it has to consolidate its presence in the field ofe-commerce.Greg Buzek, President IHL group, a global research firm specializing in technology for the retail and hospitality industries, says that Walmart understands that its growth opportunities are greatest in creating online market space. It was almost a compulsion for Walmart to forge an alliance.

Is Huge Premium a Strategic Move?

Walmarthas paid a huge premiumon the stock market value of Flipkart.The justification for doing so is the notion of synergy. The deal which is also Walmart's biggest ever, offers a greater access to the India's fast growing e-commerce market as the company is determined to challenge Amazon's increasing presence in India and elsewhere. Walmart's majority acquisition of Flipkart reflects its CEO Douglas McMillon's strategic vision to focus on high potential markets such as India and China, as reported by Bloomberg. However, Walmart would take its own time to position in the Indian market as a tough competitor to the existing and forthcoming e-commerce counterparts.

Financing the Execution

Walmart is selling its bonds to help finance its acquisition into the India's biggest online seller. Walmart's team is well-aware of the deal's impact onits profit. Walmart Inc has forecasted that this year's earning will be less than that of the previous year because of the losses expected in realizing its expensive acquisition.The experts believe that for Flipkart- Walmart partnership, loss making trend will continue till 2020, as competition with Amazon will intensify. Walmart expected its operating income during 2019-2020 to decline by a low single digit percentage range.

Douglas McMillon, the CEO and President of the Walmart, commented on the acquisition that "Walmart couldn't have built as India's most innovative and largest e-commerce platform. He said, Filpkart's other verticals such as Myntra and PhonePe hold out huge promise. PhonePe,particularly, is a service that Walmart would consider taking to other countries from India. On Flipkart's losses (Rs. 8,895 Crore in 2016-17), McMillon said, "The Flipkart investment is for the long term. My job is to drive the top line and manage the bottom line. I do this for the ventures all over the world."

Structural Shift

Acquisition of a company most often leads to restructuring which is a deliberate, significant and unusual alteration in the organization and operation of a business. (Coates IV : 2014) Immediately after the acquisition, McMillon said that the US giant will not dictate policies at Flipkart. He, further,added that theywould not make decisions for the world, and added that Binny's leadership team would decide the changes required to be made.However, within a few months after the deal, the structural shift has become apparent.

Sachin Bansal resigned, and sold its 5.6 percent share in Flipkart. Then, after a few months, even Binny Bansal resigned for various reasons.However, professionals are being hired for the key strategic positions.

Retailers' Apprehension

There is a strong fear among the Indian retailers and small businessmen that the Walmart-Flipkart deal would cause "irreversible damage" to the small traders and endanger jobs for millions. The different trade unions like Centre of Indian Trade Union (CITU), All IndiaKisan Sabha (AIKS), Chamber of Association of Maharashtra Industryand Trade (CAMIT) have aired their apprehension about the impact of this deal on the Indian business community. Mohan Gurnani, the President of CAMIT, told reporters that the worst affected would be small brick and mortar retail stores along SMEs and suppliers of goods including farmers. Mr Gurnani added that Walmart would introduce cheap Chinese goods in the Indian market which would hurt the local manufacturers and suppliers.

Approval from CCI

However, the Competition Commission of India (CCI) has approved Walmart Inc's $16 billion acquisition of online retail company Flipkart. The spokesperson of Walmart welcomed the CCI approval, and commented that the company is committed to being fully compliant with the laws and judgement of the Supreme Court, Competition Commission of India and other regulatory bodies. It claimed that complying with local regulations is a top priority for the company worldwide**.**

The Customer Perspective

What will be the impact of the partnership to the customers of Flipkart who have been using Flipkart's services to buy books and a host of electronic and other items? Will the customer be a loser or beneficiary in this global acquisition? Adrian Lee, an observer of this much hyped acquisition, remarks: Consumers should not expect significant changes in their shopping experience. User choice should be improved with a greater range of Walmart private labels differentiating the merchandise. Lee further adds, I expect discount to continue unabated. As e-commerce players mature into more profitable businesses, it is very unlikely that discounts will stop.

III. CONCLUSION

The market experts who had initially, lambasted Flipkart's business model of deep discounts and heavy expenditure and its raising of phenomenal amounts of capital at lofty valuations, have accepted the fact that 'Indian digital retail has started rolling its wheel.**'** After the execution of the deal, many of them have graciously admitted that they have been proven wrong. Entrepreneur Kashyap Deorah, the author of The Golden Tap(Deorah :2015), who was initially critical of the process, has appreciated Flipkart as "the defining Indian start-up of our generation so far." Harsh Chawla, a partner at private equity firm True North, had said in 2016 that a Venture Capital based company like Flipkart with short term investment horizon cannot compete effectively with strategic capital like Amazon**.** Following the Walmart deal, Chawla said that the American giant's entry into the Indian e-commerce space was set to change the country's retailing landscape. The Walmart-Flipkart deal ideally fits with 'Make in India' initiative. The way a strategic player like Walmart has bet on the Indian VC supported, technology driven company, is a big boost for the VC industry.

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