CHAPTER III: CONCEPTUAL FRAMEWORK

3.1. INTRODUCTION

The terms ‘mergers’, ‘acquisitions’ and ‘takeovers’ are often used interchangeably in common parlance. However, there are differences. While merger means unification of two entities into one, acquisition involves one entity buying out another and absorbing the same.

In India, in legal sense merger is known as ‘Amalgamation’. The amalgamations can be by merger of companies within the provisions of the Companies Act, and acquisition through takeovers, while takeovers are regulated by SEBI. M & A deals fall under the Companies Act. In cross border transactions, international tax considerations also arise.

Halsbury’s Laws of England defined amalgamation as a blending of two or more existing undertakings, the shareholders of each amalgamating company becoming substantially the shareholders in the amalgamating company. Accordingly, in a merger, two or more companies combine into a single unit.

The term “amalgamation” is used when two or more companies are amalgamated or where one is merged with another or taken over by another. In Inland steam Navigation Workers Union vs. R.S. Navigation Company Ltd. it was observed that in case of amalgamation, the rights and liabilities of a company are amalgamated into another so that the transferee company becomes vested with all rights and liabilities of the transferor company.

An acquisition is when both the acquiring and acquired companies are still left standing as separate entities at the end of the transaction. A merger results in the legal dissolution of one of the companies, and a consolidation dissolves both of the parties and creates a new one, into which the previous entities are merged.
3.2. HISTORY OF MERGERS AND ACQUISITIONS

Tracing back to history, merger and acquisitions have evolved in five stages and each of these are discussed here. As seen from past experience mergers and acquisitions are triggered by economic factors. The macroeconomic environment, which includes the growth in GDP, interest rates and monetary policies play a key role in designing the process of mergers or acquisitions between companies or organizations.

1. First Wave Mergers

The first wave mergers commenced from 1897 to 1904. During this phase merger occurred between companies, which enjoyed monopoly over their lines of production like railroads, electricity etc. The first wave mergers that occurred during the aforesaid time period were mostly horizontal mergers that took place between heavy manufacturing industries.

End of 1st Wave Merger

Majority of the mergers that were conceived during the 1st phase ended in failure since they could not achieve the desired efficiency. The failure was fuelled by the slowdown of the economy in 1903 followed by the stock market crash of 1904. The legal framework was not supportive either. The Supreme Court passed the mandate that the anticompetitive mergers could be halted using the Sherman Act.

2. Second Wave Mergers

The second wave mergers that took place from 1916 to 1929 focused on the mergers between oligopolies, rather than monopolies as in the previous phase. The economic boom that followed the post World War I gave rise to these mergers. Technological developments like the development of railroads and transportation by motor vehicles provided the necessary infrastructure for such mergers or acquisitions to take place. The government policy encouraged firms to work in unison. This policy was implemented in the 1920s.

The 2nd wave mergers that took place were mainly horizontal or conglomerate in nature. The industries that went for merger during this phase were producers of primary metals, food products, petroleum products, transportation equipments and
chemicals. The investments banks played a pivotal role in facilitating the mergers and acquisitions.

**End of 2nd Wave Mergers**

The 2nd wave mergers ended with the stock market crash in 1929 and the Great Depression. The tax relief that was provided inspired mergers in the 1940s.

**3. Third Wave Mergers**

The mergers that took place during this period (1965-69) were mainly conglomerate mergers. Mergers were inspired by high stock prices, interest rates and strict enforcement of antitrust laws. The bidder firms in the 3rd wave merger were smaller than the Target Firm. Mergers were financed from equities; the investment banks no longer played an important role.

**End of the 3rd Wave Merger**

The 3rd wave merger ended with the plan of the Attorney General to split conglomerates in 1968. It was also due to the poor performance of the conglomerates. Some mergers in the 1970s have set precedence. The most prominent ones were the INCO-ESB merger; United Technologies and OTIS Elevator Merger, are the merger between Colt Industries and Garlock Industries.

**4. Fourth Wave Merger**

The 4th wave merger that started from 1981 and ended by 1989 was characterized by acquisition targets that were much larger in size as compared to the 3rd wave mergers. Mergers took place between the oil and gas industries, pharmaceutical industries, banking and airline industries. Foreign takeovers became common with most of them being hostile takeovers. The 4th Wave mergers ended with anti takeover laws, Financial Institutions Reform and the Gulf War.

**5. Fifth Wave Merger**

The 5th Wave Merger (1992-2000) was inspired by globalization, stock market boom and deregulation. The 5th Wave Merger took place mainly in the banking and telecommunications industries. They were mostly equity financed rather than debt
financed. The mergers were driven by long term rather than short term profit motives. The 5th Wave Merger ended with the burst of the stock market bubble.

Hence we may conclude that the evolution of mergers and acquisitions has been long drawn. Many economic factors have contributed its development. There are several other factors that have impeded their growth. As long as economic units of production exist mergers and acquisitions would continue for an ever-expanding economy.

3.3. MEANING

Mergers, acquisitions and takeovers have been a part of the business world for centuries. In today's dynamic economic environment, companies are often faced with decisions concerning these actions - after all, the job of management is to maximize shareholder value. Through mergers and acquisitions, a company can (at least in theory) develop a competitive advantage and ultimately increase shareholder value. The said terms to a layman may seem alike but in legal/corporate terminology, they can be distinguished from each other:

1. Merger

A full joining together of two previously separate corporations. A true merger in the legal sense occurs when both businesses dissolve and fold their assets and liabilities into a newly created third entity. This entails the creation of a new corporation.

2. Acquisition

This refers to the purchase of controlling interest by one company in the share capital of an existing company. This may be by:

   (i) an agreement with majority holder of Interest.

   (ii) Purchase of new shares by private agreement.

   (iii) Purchase of shares in open market (open offer)

   (iv) Acquisition of share capital of a company by means of cash, issuance of shares.
(v) Making a buyout offer to general body of shareholders.

When a company is acquired by another company, the acquiring company has two choices either to merge both the companies into one and function as a single entity and the other is to operate the takeover company as an independent entity with changed management and policies. The first choice is termed as ‘Merger’, whereas the second choice is known as ‘takeover’

3. Reconstruction

The expression “reconstruction” means the transfer of the undertaking and business of a company or several companies to a new company specially formed for the purpose. In other words, reconstruction involves the winding-up of an existing company and transfer of its asset and liabilities to a new company formed to take the place of the existing company. In the result, the same shareholders who agree to take equivalent shares in the new company, carry on the same enterprise through the medium of a new company. Based on the decision in Brooklands Selangor Holdings Ltd. v. Commissioners of Inland Revenue (1970) 1 WLR 429, Stephen W. Mayson and Derek French have clearly brought out the meaning of the term ‘reconstruction’ as follows:

“A company is reconstructed if it is built again; in other words, if it is dissolved and its business and property are sold to a new company which takes the business and property as capital contributed for the issue of its shares. The company may have a different capital structure from the old one, or have different objects, or be incorporated in a different country, but an essential feature of a reconstruction is that the new company’s membership is substantially the same as that of the old company.

4. Joint Venture

Two or more businesses join together under a contractual agreement to conduct a specific business enterprise with both parties sharing profits and losses. The venture is for one specific project only, rather than for a continuing business relationship as in a strategic alliance.
5. Strategic Alliance

A partnership with another business in which you combine efforts in a business effort involving anything from getting a better price for goods by buying in bulk together to seeking business together with each of you providing part of the product. The basic idea behind alliances is to minimize risk while maximizing your leverage.

6. Partnership

A business in which two or more individuals who carry on a continuing business for profit as co-owners. Legally, a partnership is regarded as a group of individuals rather than as a single entity, although each of the partners file their share of the profits on their individual tax returns.

Many mergers are in truth acquisitions. One business actually buys another and incorporates it into its own business model. Because of this misuse of the term merger, many statistics on mergers are presented for the combined mergers and acquisitions (M&A) that are occurring. This gives a broader and more accurate view of the merger market.

3.4. TERMS RELATING TO MergERS AND ACQUISITIOnS

Following are the some of the important terms that are used to explain the concepts of merger and acquisition.

1. Asset Stripping

When a company acquires another and sells it in parts expecting that the funds generated would match the costs of acquisition, it is known as asset stripping.

2. Black Knight

The company that makes a hostile takeover is known as the Black Knight.

3. Dawn Raid

This is a process of buying shares of the target company with the expectation that the market prices may fall till the acquisition is completed.
4. Demerger or Spin off

During the process of corporate restructuring, a part of the company may break up and set up as a new company and this is known as demerger. Zeneca and Argos are good examples in this regard that split from ICI and American Tobacco respectively.

5. Carve –out

This is a case of selling a small portion of the company as an Initial Public Offering.

6. Greenmail

Greenmail is a situation where the target company purchases back its own shares from the bidding company at a higher price.

7. Grey Knight

A grey knight is a company that takes over another company and its intentions are not clear.

8. Hostile Takeover

Hostile bids occur when acquisitions take place without the consent of the directors of the target company. This confrontation on the part of the directors of the target company may be short lived and the hostile takeover may end up being friendly. Most American and British companies like the phenomenon of hostile takeovers while there are some more which do not like such unfriendly takeovers.

9. Macaroni Defense

Macaroni Defense is a strategy that is taken up to prevent any hostile takeovers. The issue of bonds that can be redeemed at a higher price if the company is taken over does this.

10. Management Buy In

When a company is purchased and the investors bring in their managers to control the company, it is known as management buyout.

11. Management Buy Out

In a management buy out, the managers of a company purchases it with support from venture capitalists.
12. Poison Pill Or Suicide Pill Defense

This is a strategy that is taken by the target company to make itself less appealing for a hostile takeover. The bondholders are given the right to redeem their bonds at a premium should a takeover occur.

3.5 TYPES OF MERGER

A merger refers to the process whereby at least two companies combine to form one single company. Business firms make use of mergers and acquisitions for consolidation of markets as well as for gaining a competitive edge in the industry.

Merger types can be broadly classified into the following five subheads as described below.

They are Horizontal Merger, Conglomeration, Vertical Merger, Product-Extension Merger and Market-Extension Merger.

*Horizontal Merger* refers to the merger of two companies who are direct competitors of one another. They serve the same market and sell the same product.

*Conglomeration* refers to the merger of companies, which do not either sell any related products or cater to any related markets. Here, the two companies entering the merger process do not possess any common business ties.

*Vertical Merger* is effected either between a company and a customer or between a company and a supplier.

*Product-Extension Merger* is executed among companies, which sell different products of a related category. They also seek to serve a common market. This type of merger enables the new company to go in for a pooling in of their products so as to serve a common market, which was earlier fragmented among them.

*Market-Extension Merger* occurs between two companies that sell identical products in different markets. It basically expands the market base of the product.

I. **Horizontal Mergers**

II. **Vertical Mergers**

III. **Market Extension Merger and Product Extension Merger**
IV. Conglomerate Mergers

I. Horizontal Mergers

About Horizontal Mergers

Horizontal mergers are those mergers where the companies manufacturing similar kinds of commodities or running similar type of businesses merge with each other. The principal objective behind this type of mergers is to achieve economies of scale in the production procedure through carrying off duplication of installations, services and functions, widening the line of products, decrease in working capital and fixed assets investment, getting rid of competition, minimizing the advertising expenses, enhancing the market capability and to get more dominance on the market.

Nevertheless, the horizontal mergers do not have the capacity to ensure the market about the product and steady or uninterrupted raw material supply. Horizontal mergers can sometimes result in monopoly and absorption of economic power in the hands of a small number of commercial entities.

According to strategic management and microeconomics, the expression horizontal merger delineates a form of proprietorship and control. It is a plan, which is utilized by a corporation or commercial enterprise for marketing a form of commodity or service in a large number of markets. In the context of marketing, horizontal merger is more prevalent in comparison to horizontal merger in the context of production or manufacturing.

Horizontal Integration

Sometimes, horizontal merger is also called as horizontal integration. It is totally opposite in nature to vertical merger or vertical integration.

Horizontal Monopoly

A monopoly formed by horizontal merger is known as a horizontal monopoly. Normally, a monopoly is formed by both vertical and horizontal mergers. Horizontal merger is that condition where a company is involved in taking over or acquiring another company in similar form of trade. In this way, a competitor is done away with and a wider market and higher economies of scale are accomplished.
In the process of horizontal merger, the downstream purchasers and upstream suppliers are also controlled and as a result of this, production expenses can be decreased.

**Horizontal Expansion**

An expression which is intimately connected to horizontal merger is horizontal expansion. This refers to the expansion or growth of a company in a sector that is presently functioning. The aim behind a horizontal expansion is to grow its market share for a specific commodity or service.

**Examples of Horizontal Mergers**

Following are the important examples of horizontal mergers:

- The formation of Brook Bond Lipton India Ltd. through the merger of Lipton India and Brook Bond
- The merger of Bank of Mathura with ICICI (Industrial Credit and Investment Corporation of India) Bank
- The merger of BSES (Bombay Suburban Electric Supply) Ltd. with Orissa Power Supply Company
- The merger of ACC (erstwhile Associated Cement Companies Ltd.) with Damodar Cement

**Advantages of Horizontal Merger:**

Horizontal merger provides the following advantages to the companies which are merged:

1) **Economies of scope**

The notion of economies of scope resembles that of economies of scale. Economies of scale principally denote effectiveness related to alterations in the supply side, for example, growing or reducing production scale of an individual form of commodity. On the other hand, economies of scope denote effectiveness principally related to alterations in the demand side, for example growing or reducing the range of marketing and supply of various forms of products. Economies of scope are one of the
principal causes for marketing plans like product lining, product bundling, as well as family branding.

2) Economies of scale

Economies of scale refer to the cost benefits received by a company as a result of a horizontal merger. The merged company is able to have bigger production volume in comparison to the companies operating separately. Therefore, the merged company can derive the benefits of economies of scale. The maximum use of plant facilities can be done by the merged company, which will lead to a decrease in the average expenses of the production.

The important benefits of economies of scale are the following:

- Synergy
- Growth or expansion
- Risk diversification
- Diminution in tax liability
- Greater market capability and lesser competition
- Financial synergy (Improved creditworthiness, enhancement of borrowing power, decrease in the cost of capital, growth of value per share and price earning ratio, capital raising, smaller flotation expenses)
- Motivation for the managers

For attaining economies of scale, there are two methods and they are the following:

- Increased fixed cost and static marginal cost
- No or small fixed cost and decreasing marginal cost

One example of economies of scale is that if a company increases its production twofold, then the entire expense of inputs goes up less than twofold.

3) Dominant existence in a particular market
II. Vertical Mergers

Vertical mergers refer to a situation where a product manufacturer merges with the supplier of inputs or raw materials. In can also be a merger between a product manufacturer and the product's distributor.

Vertical mergers may violate the competitive spirit of markets. It can be used to block competitors from accessing the raw material source or the distribution channel. Hence, it is also known as "vertical foreclosure". It may create a sort of bottleneck problem.

As per research, vertical integration can affect the pricing incentive of a downstream producer. It may also affect a competitors incentive for selecting input suppliers. Research studies single out several factors, which point to the fact that vertical integration facilitates collusion. Vertical mergers may promote collusion through an outlets effect. A corollary of vertical integration is that integrated business structures are able to perform better in crisis phases.

There are multiple reasons, which promote the vertical integration by firms. Some of them are discussed below.

✓ The prime reason being the reduction of uncertainty regarding the availability of quality inputs as also the uncertainty regarding the demand for its products.

✓ Firms may also enter vertical mergers to avail the plus points of economies of integration.

✓ Vertical merger may make the firms cost-efficient by streamlining its distribution and production costs. It is also meant for the reduction of transactions costs like marketing expenses and sales taxes. It ensures that a firm's resources are used optimally.

Bird's Eye View of US Laws Pertaining to Vertical Mergers

In USA the vertical mergers abide by the 'Clayton Act (15 U.S.C.A. § 12 et seq.)'. The transactions conducted here fall under the purview of antitrust acts.

It is interesting to note that vertical mergers do not lead to a fall in the number of operating economic agents at a particular market level. However, it may result in a change of industry behavior pattern.
At its worst suppliers might be faced with a loss of product market. The retail chains may run out of stock. Competitors may also face blockages for supplies as well as outlets.

Vertical mergers by virtue of their market power may effectively block new firms from entering the market thereby violating the competitive flavor of the market.

The Supreme Court of USA has given a ruling on just 3 cases pertaining to vertical merger under the “Clayton Act (section 7)” as per the latest available information.

In the first case the Court contradicted the general assumption that section 7 was not applicable for vertical mergers.

In the following vertical merger case the US Supreme Court observed that the primary disadvantage of vertical merger lies in the throttling of the spirit and essence of competition. Business rivals may be denied a fair chance at competition.

The Court observed that regarding vertical mergers two areas need close scrutiny and regulation.

One concerns the purpose and nature of the vertical merger arrangement. The other parameter concerns the industry concentration trend in that specific sector.

In the third judgment passed on vertical merger US Supreme Court quashed Ford's claim that its acquisition of Autolite had made the latter a better competitor.

Thus a vertical merger is a situation where a firm acquires a product supplier or a customer. Vertical mergers may at times violate the US federal antitrust laws.

**Gist of European Commission Guidelines on Vertical Mergers**

In 2007 the European Commission released a new set of guidelines for non-horizontal mergers. It can be noted that vertical merger is a type of non-horizontal merger. The Commission is the regulatory body overseeing the compliance aspect of firms going for vertical mergers.

The guidelines cited instances where conglomerate and vertical mergers significantly affected the competitive nature of the market.

The European Commission normally is not bothered about 'competition concerns' in what is commonly known as 'safe harbors'. The guidelines set benchmarks for market share levels and concentration levels below which comes the 'safe harbors'. Market
analysts consider this 'safe harbor' aspect of the new guidelines to be an innovative one.

Seen in overall terms, the new guidelines from the European Commission aims at providing a transparent regulatory guideline framework for the business community as well as the legal fraternity.

III. Market Extension Merger and Product Extension Merger

Market extension merger and product extension merger are the two basic types of mergers. These two mergers have become very common in the modern day financial market. These have also become very important as more companies are looking at extending the base of their operations as well as the range of products and services they deal in.

i. Market Extension Merger

As per definition, market extension merger takes place between two companies that deal in the same products but in separate markets. The main purpose of the market extension merger is to make sure that the merging companies can get access to a bigger market and that ensures a bigger client base.

Example of Market Extension Merger

A very good example of market extension merger is the acquisition of Eagle Bancshares Inc by the RBC Centura. Eagle Bancshares is headquartered at Atlanta, Georgia and has 283 workers. It has almost 90,000 accounts and looks after assets worth US $1.1 billion.

Eagle Bancshares also holds the Tucker Federal Bank, which is one of the ten biggest banks in the metropolitan Atlanta region as far as deposit market share is concerned. One of the major benefits of this acquisition is that this acquisition enables the RBC to go ahead with its growth operations in the North American market.

With the help of this acquisition RBC has got a chance to deal in the financial market of Atlanta, which is among the leading upcoming financial markets in the USA. This move would allow RBC to diversify its base of operations.
ii. Product Extension Merger

According to definition, product extension merger takes place between two business organizations that deal in products that are related to each other and operate in the same market. The product extension merger allows the merging companies to group together their products and get access to a bigger set of consumers. This ensures that they earn higher profits.

Example of Product Extension Merger

The acquisition of Mobilink Telecom Inc. by Broadcom is a proper example of product extension merger. Broadcom deals in the manufacturing Bluetooth personal area network hardware systems and chips for IEEE 802.11b wireless LAN.

Mobilink Telecom Inc. deals in the manufacturing of product designs meant for handsets that are equipped with the Global System for Mobile Communications technology. It is also in the process of being certified to produce wireless networking chips that have high speed and General Packet Radio Service technology. It is expected that the products of Mobilink Telecom Inc. would be complementing the wireless products of Broadcom.

Difference between Market Extension Merger and Product Extension Merger

The difference between market extension merger and product extension merger lies in the fact that the later is meant to add to the existing variety of products and services offered by the respective merging companies; while, in case of the former the two merging companies are dealing in similar products.

In case of the market extension merger the two merging companies are operating in the same market and as far as product extension merger is concerned the two merging companies are operating in different markets.

IV. Conglomerate Mergers

As per definition, a conglomerate merger is a type of merger whereby the two companies that merge with each other are involved in different sorts of businesses. The importance of the conglomerate mergers lies in the fact that they help the merging companies to be better than before.
Types of Conglomerate Mergers

There are two main types of conglomerate mergers – the *pure conglomerate merger* and the *mixed conglomerate merger*.

The *pure conglomerate merger* is one where the merging companies are doing businesses that are totally unrelated to each other.

The *mixed conglomerate mergers* are ones where the companies that are merging with each other are doing so with the main purpose of gaining access to a wider market and client base or for expanding the range of products and services that are being provided by them.

There are also some other subdivisions of conglomerate mergers like the financial conglomerates, the concentric companies, and the managerial conglomerates.

Reasons of Conglomerate Mergers

There are several reasons as to why a company may go for a conglomerate merger. Among the more common reasons are adding to the share of the market that is owned by the company and indulging in cross selling. The companies also look to add to their overall synergy and productivity by adopting the method of conglomerate mergers.

Benefits of Conglomerate Mergers

There are several advantages of the conglomerate mergers. One of the major benefits is that conglomerate mergers assist the companies to diversify. As a result of conglomerate mergers the merging companies can also bring down the levels of their exposure to risks.

Implications of Conglomerate Mergers

There are several implications of conglomerate mergers. It has often been seen that companies are going for conglomerate mergers in order to increase their sizes. However, this also, at times, has adverse effects on the functioning of the new company. It has normally been observed that these companies are not able to perform like they used to before the merger took place.
This was evident in the 1960s when the conglomerate mergers were the general trend. The term conglomerate mergers also implies that the two companies that are merging do not even have the same customer base as they are in totally different businesses.

It has normally been seen that a lot of companies that go for conglomerate mergers are able to manage a wide variety of activities in a particular market. For example, these companies can carry out research activities and applied engineering processes. They are also able to add to their production as well as strengthen the marketing area that ensures better profitability.

It has been seen from case studies that conglomerate mergers do not affect the structures of the industries. However, there might be significant impact if the acquiring company happens to be a leading company of its market that is not concentrated and has a large number of entry barriers.

3.6 MOTIVES BEHIND M & A

These motives are considered to add shareholder value:

i. **Economies of Scale**

This generally refers to a method in which the average cost per unit is decreased through increased production, since fixed costs are shared over an increased number of goods. In a layman's language, more the products, more is the bargaining power. This is possible only when the companies merge/combine/acquired, as the same can often obliterate duplicate departments or operation, thereby lowering the cost of the company relative to theoretically the same revenue stream, thus increasing profit. It also provides varied pool of resources of both the combining companies along with a larger share in the market, wherein the resources can be exercised.

ii. **Economies of scope**

Economies of scope are conceptually similar to economies of scale. Whereas 'economies of scale' for a firm primarily refers to reductions in average cost (cost per unit) associated with increasing the scale of production for a single product type, 'economies of scope' refers to lowering average cost for
a firm in producing two or more products. The term and concept development are due to Panzar and Willig (1977, 1981). Here, economies of scope make product diversification efficient if they are based on the common and recurrent use of proprietary know-how or on an indivisible physical asset. For example as the number of products promoted is increased, more people can be reached per dollar spent. At some point, additional advertising expenditure on new products may start to be less effective (an example of diseconomies of scope). Related examples and distribution of different types of products, product bundling, product lining, and family branding.

If a sales force is selling several products they can often do so more efficiently than if they are selling only one product. The cost of their travel time is distributed over a greater revenue base, so cost efficiency improves. There can also be synergies between products such that offering a complete range of products gives the consumer a more desirable product offering than a single product would. Economies of scope can also operate through distribution efficiencies. It can be more efficient to ship a range of products to any given location than to ship a single type of product to that location.

Further economies of scope occur when there are cost-savings arising from by-products in the production process. An example would be the benefits of heating from energy production having a positive effect on agricultural yields.

A company which sells many product lines, sells the same product in many countries, or sells many product lines in many countries will benefit from reduced risk levels as a result of its economies of scope. If one of its product lines falls out of fashion or one country has an economic slowdown, the company will, most likely, be able to continue trading.

Not all economists agree on the importance of economies of scope. Some argue that it only applies to certain industries, and then only rarely.

iii. Increased revenue /Increased Market Share

This motive assumes that the company will be absorbing the major competitor and thus increase its power (by capturing increased market share) to set prices.
iv. **Cross selling**

Cross-selling is defined as "the action or practice of selling among or between established clients, markets, traders, etc." or "that of selling an additional product or service to an existing customer". This article deals exclusively with the latter meaning. In practice, businesses define cross-selling in many different ways. Elements that might influence the definition might include: the size of the business, the industry sector it operates within and the financial motivations of those required to define the term.

The objectives of cross-selling can be either to increase the income derived from the client or clients or to protect the relationship with the client or clients.

The approach to the process of cross-selling can be varied.

Unlike the acquiring of new business, cross-selling involves an element of risk that existing relationships with the client could be disrupted. For this reason, it is important to ensure that the additional product or service, being sold to the client or clients, enhances the value the client or clients get from the organization.

In practice, large businesses usually combine cross-selling and up-selling techniques to enhance the value that the client or clients get from the organization (and vice versa).

For example, a bank buying a stock broker could then sell its banking products to the stock brokers customers, while the broker can sign up the bank’s customers for brokerage account. Or, a manufacturer can acquire and sell complimentary products.

v. **Corporate Synergy**

Better use of complimentary resources. It may take the form of revenue enhancement (to generate more revenue than its two predecessor standalone companies would be able to generate) and cost savings (to reduce or eliminate expenses associated with running a business).
vi. **Taxes**

A profitable company can buy a loss maker to use the target's loss as their advantage by reducing their tax liability. In the United States and many other countries, rules are in place to limit the ability of profitable companies to "shop" for loss making companies, limiting the tax motive of an acquiring company. Tax minimization strategies include purchasing assets of a non-performing company and reducing current tax liability under the Tanner-White PLLC Troubled Asset Recovery Plan.

A profitable company can buy a loss maker to use the target’s tax right off i.e. wherein a sick company is bought by giants.

vii. **Geographical or other diversification**

This is designed to smooth the earning results of a company, which over the long term smoothen the stock price of the company giving conservative investors more confidence in investing in the company. However, this does not always deliver value to shareholders.

viii. **Resource transfer**

Resources are unevenly distributed across firms and interaction of target and acquiring firm resources can create value through either overcoming information asymmetry or by combining scarce resources. E.g.: Laying off employees, reducing taxes etc.

ix. **Improved market reach and industry visibility**

Companies buy companies to reach new markets and grow revenues and earnings. A merge may expand two companies' marketing and distribution, giving them new sales opportunities. A merger can also improve a company's standing in the investment community: bigger firms often have an easier time raising capital than smaller ones.

x. **Elimination of competition**

The merger or amalgamation of two or more companies will eliminate competition among them. The companies will be able to save their advertisement expenses thus enabling them to reduce their prices. The
consumers will also benefit in the form of cheap goods being available to them.

xi. **Better financial planning**

The merged companies will be able to plan their resources in a better way. The collective finances of merged companies will be more and their utilization may be better than in the separate concerns. It may happen that one of the merging companies has short gestation period while the other has the longer gestation period. The profits of the company with short gestation period will be utilized to finance the other company. When the company with the longer gestation period starts earning profits then it will improve financial position as a whole.

xii. **Growth**

A company may not grow rapidly through internal expansion. Merger or amalgamation enables satisfactory and balanced growth of a company. It can cross many stages of growth at one time through amalgamation. Growth through merger or amalgamation is also cheaper and less risky. A number of costs and risk of expansion and taking on a new product line are avoided by the acquaint of a going concern. By acquiring other companies a desired level of growth can be maintained by an enterprise.
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3.7 MERGERS & ACQUISITIONS EFFECTS

1] Taxes issues in M & A

The tax consequences with respect to mergers are similar to those of acquisitions under the Indian income tax act. The relevant section clearly states that the “amalgamation of companies means either mergers of one or more companies with another company or the merger of two or more companies to form another company”. In India, the tax provisions of the income tax boost M & A. companies often undertake M & A in order to take the benefit of carry forward and set off of operating losses, or tax credits. Taxes on M & A differ from country to country. They are a consequence of differences of regimes.

Illustration: Tax structure of countries should be compatible for cross border M&A. The effective tax rate for domestic companies is 33.66% and 41.62% for foreign companies. Corporate tax rate in India is higher when compared to other transnational countries and very often cross-border M&A deals are struck when they come to the tax issue.

2] Capital Gains

M & A attract capital gains tax in the hands of the amalgamated company/acquired company on the sale of its assets and shares. However the treatment of taxing capital gains is not the same globally. A few countries such as Singapore and Malaysia, tax capital gains on real estate or shares in real estate at special rates, while Hong Kong exempts capital gains. Indonesia and Thailand tax the capital gains arising on the sale of shares and other assets at the normal rates of tax.

In India, any transfer of a capital asset in a scheme of amalgamation by the amalgamating company, to the amalgamated company is taxable under the head “capital gains”. However, if the amalgamated company is an Indian company, it is exempted from capital gains tax. The tax treatment of capital gains in Australia and the US is similar to that of India. In India subject to fulfilling certain conditions, the transfer of capital assets by the amalgamating company is not taken as “Transfer” and hence, does not attract capital gains.
3] **Tax losses**

One of the motivating factors for M & A is the carry forward of tax losses. If the acquiring company is a profit making entity, it can set off of the losses of the acquired company against its profits, and can reduce the assets at a higher market value. Carry forward and set of losses is a strategically required provision especially when the amalgamating company is loss making and is unable to make potential utilization of its resources. In India, the unabsorbed losses and the unabsorbed depreciation of the amalgamating company, subject to certain conditions is transferred and can be claimed by the amalgamated company. This provision holds good in the case of cross border M & As.

**Illustration:** The biggest deal in cement industry in 2005 was the Gujrat Ambuja Cement’s strategic alliances with Swiss Cement major Holcim Ltd. Under the agreement, 67% of the equity share capital of ACIL was acquired by Holcim group and the rest (33%) was retained by GACL. ACIL had acquired a 50.01% stake in ACC. Holcim is the second largest company in the world and looking to enter the business into India.

4] **Effects on shareholders**

Mergers and Acquisitions is the frequently used growth strategy, more so in the case of developed countries. The strategy works to pass on the benefit to the share holder and increase their share value and wealth. The share holders in the acquired firm benefit substantially because the market price of their holding post merger is 20-30% more than the market price prior to the merger.

5] **Effects on Accounting for M & A**

Accounting aspects of mergers and acquisitions are not as difficult as its taxation aspects. Traditionally there are two methods: Purchase method and The Pooling-of-interests methods. A big question for the management is which method to use, and number of criteria determine whether a company can use either of these two methods.

**Illustration:** Cross-border mergers and acquisitions accounting statements of countries differ and they have to harmonize on international context so as to make entries in M&A in parametric with international standards and to be dissolved.
6] **Reducing costs relative to competitors**

An acquisitions based growth strategy can be especially effective in fragmented industries, where companies can use M & A to consolidate the industry and achieve scale and cost advantage. The pharmaceutical industry is a classic example. Until the early 1990s the industries remained relatively fragmented, with no company responsible for more than 5% of sales. But the last decade has seen a wave of acquisitions. Aggressive acquirers have been able to cut their combined cost based in administration, sales, and R&D by 8% on average and by as much as 18% in individual cases. These cost reductions have led to improvements in earnings performance ranging from 20% to 35% and have given highly acquisitive pharmaceutical companies significant advantages over their rivals.

**Illustration:** Competition in the Indian automobile sector has increased in the last decade with entry of major global players like GM, Toyota, Ford etc. Indian companies were not able to compete with global players in terms of quality and price. This leads to cross border mergers and acquisitions in past. Now M&A activities are increased due to increased outsourcing market. Cheap labor and high quality engineering skills have attracted various foreign players to establish their base in India.

7] **Acquiring necessary capabilities**

Other companies use acquisitions to fill in gaps in capability rather than wait to develop those capabilities internally. Since the mid 1980’s, for e.g., Cisco systems has acquired some 82 companies to established its dominant position in the data networking industry. Even with the massive declines in market value incurred by Cisco in the aftermath of the late 1990’s boom Cisco had an average annual TSR of 28.2% during the 10 years and outperformed the SNP 500 by nearly 18% points.

In the fast moving data networking business, intelligent acquisition is the most effective way to keep paste with technological innovation. In effect, acquisition has become an integral part of Cisco’s R&D strategy. More than half of Cisco’s
acquisitions were made either to expand its offerings or to enhance the functionality of its current offerings.

**Illustration:** Cisco has developed extremely effective capabilities in target search and selection, negotiation and rapid integration. The company is extremely thorough in its search process. On average, it considers three potential markets for every one it actually enters and accesses 5-10 candidates for every deal it consummates.

8] **Building the new business model**

Another effective strategy is to use acquisition as a way to rapidly scale up a new business model. This was the approach taken by the Newell Corporation. The evolution of Newell is the dramatic example both of the success a company can achieve by using acquisitive growth to establish a new way of doing business and of what can go wrong when a company strays from its proven strategy for acquisitive growth.

**Illustration:** Mittal and Arcelor bid. Mittal has grown from strength to strength by acquiring and turning around loss making steel plants, a strategy he employed ever since he leased a loss making steel unit in Trinidad & Tobago in 1988. Arcelor is itself a result of consolidation, formed by the combination of Aceralia, Arbed and Unisor in 2002.

9] **Realizing value through effective post merger integration**

In the end it is not the acquisition itself that creates value but rather the post merger integration. This is where the synergies that will pay for the acquisition are actually realized. Effective post merger integration is a completed balancing act. On the other hand, potential synergies must be realized quickly in the first 12 to 18 months after deal in order to communicate to the market that the merger is on track.

On the other hand integration has to be thorough. Executing the post merger integration is such a high pressure activity; there is a great temptation to declare victory too early. Potential synergies are identified but never completely captured because the organization loses its concentration.
Illustration: Bajaj Hindustan Ltd., has acquired 7,20,000 equity shares of Rs.10 each, representing 20% of the total shares capital of The Pratappur Sugar & Industries Ltd., at a price of Rs.63.50 per share payable in cash.

10] Strategies for acquisitive growth

There is no inherent disadvantage to grow by acquisition. But that doesn’t necessarily mean that company should pursue it under any and all circumstances. Acquisitive growth makes sense only when executives can use acquisitions to create sustainable competitive advantage. One requirement is world-class M&A implementation skills but success is first and foremost a question of strategy. Consider three common strategies in which acquisitions can make decisive contributions to competitive advantage.

Illustration: Newell began its existence in 1902 as a curtain rod manufacturer. By the early 1970 it was still a relatively small company with less than $100 million in revenues. But company executives had been observing the growing dominance of large and concentrated retailers such as Kmart and Wal-Mart. The joint retailers were selling billions of dollars worth of merchandise supplied by myriad small manufacturers with only a few million dollars in revenue. But the proliferation of small suppliers posed logistics headaches and quality problems for the retailers and the small companies often lacked the resources to improve. Retailers would welcome a low cost supplier large enough to meet them on their own terms- a company that could simplify purchasing and logistics, provide consistently high quality products and offer lower prices. So, Newell set out to become a one stop shop for mega retailers.

11] Sales and marketing synergy

When products use common distribution channels, common sales administration or common warehousing.

Opportunity for a try in sale offered by a complete line of related products increases the productivity of sales force. Common advertising, sales promotion, past reputation, distribution channel, new market opportunity and cost advantage can all have multiple returns.
4 P’s i.e. Marketing Mix—Product, Price, Place and Promotion plays important role in port folio or matrix expands. Product mix provides more option for customers. This leads to Reduction in prices. The readymade distribution channel network available and Promotion using brand value that’s why the M & A activities are in boom.

3.8 LAWS REGULATING MERGER

Following are the laws that regulate the merger of the company:-

I  The Companies Act, 1956

Section 390 to 395 of Companies Act, 1956 deal with arrangements, amalgamations, mergers and the procedure to be followed for getting the arrangement, compromise or the scheme of amalgamation approved. Though, section 391 deals with the issue of compromise or arrangement which is different from the issue of amalgamation as deal with under section 394, as section 394 too refers to the procedure under section 391 etc., all the section are to be seen together while understanding the procedure of getting the scheme of amalgamation approved. Again, it is true that while the procedure to be followed in case of amalgamation of two companies is wider than the scheme of compromise or arrangement though there exists substantial overlapping.

The procedure to be followed while getting the scheme of amalgamation and the important points, are as follows:-

i. Any company, creditors of the company, class of them, members or the class of members can file an application under section 391 seeking sanction of any scheme of compromise or arrangement. However, by its very nature it can be understood that the scheme of amalgamation is normally presented by the company. While filing an application either under section 391 or section 394, the applicant is supposed to disclose all material particulars in accordance with the provisions of the Act.
ii. Upon satisfying that the scheme is prima facie workable and fair, the Tribunal order for the meeting of the members, class of members, creditors or the class of creditors. Rather, passing an order calling for meeting, if the requirements of holding meetings with class of shareholders or the members, are specifically dealt with in the order calling meeting, then, there won’t be any subsequent litigation. The scope of conduct of meeting with such class of members or the shareholders is wider in case of amalgamation than where a scheme of compromise or arrangement is sought for under section 391

iii. The scheme must get approved by the majority of the stakeholders’ viz., the members, class of members, creditors or such class of creditors. The scope of conduct of meeting with the members, class of members, creditors or such class of creditors will be restrictive some what in an application seeking compromise or arrangement.

iv. There should be due notice disclosing all material particulars and annexing the copy of the scheme as the case may be while calling the meeting.

v. In a case where amalgamation of two companies is sought for, before approving the scheme of amalgamation, a report is to be received form the registrar of companies that the approval of scheme will not prejudice the interests of the shareholders.

vi. The Central Government is also required to file its report on an application seeking approval of compromise, arrangement or the amalgamation as the case may be under section 394A.

vii. After complying with all the requirements, if the scheme is approved, then, the certified copy of the order is to be filed with the concerned authorities.

II The Competition Act, 2002

i. Following provisions of the Competition Act, 2002 deal with mergers of the company:-

Section 5 of the Competition Act, 2002 deals with “Combinations” which defines combination by reference to assets and turnover
(a) exclusively in India and
(b) in India and outside India.

For example, an Indian company with turnover of Rs. 3000 crores cannot acquire another Indian company without prior notification and approval of the Competition Commission. On the other hand, a foreign company with turnover outside India of more than USD 1.5 billion (or in excess of Rs. 4500 crores) may acquire a company in India with sales just short of Rs. 1500 crores without any notification to (or approval of) the Competition Commission being required.

ii. Section 6 of the Competition Act, 2002 states that, no person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

All types of intra-group combinations, mergers, demergers, reorganizations and other similar transactions should be specifically exempted from the notification procedure and appropriate clauses should be incorporated in sub-regulation 5(2) of the Regulations. These transactions do not have any competitive impact on the market for assessment under the Competition Act, Section 6.

III Foreign Exchange Management Act, 1999

The foreign exchange laws relating to issuance and allotment of shares to foreign entities are contained in The Foreign Exchange Management (Transfer or Issue of Security by a person residing out of India) Regulation, 2000 issued by RBI vide GSR no. 406(E) dated 3rd May, 2000. These regulations provide general guidelines on issuance of shares or securities by an Indian entity to a person residing outside India or recording in its books any transfer of security from or to such person. RBI has issued detailed guidelines on foreign investment in India vide “Foreign Direct Investment Scheme” contained in Schedule 1 of said regulation.

IV SEBI Take over Code 1994
SEBI Takeover Regulations permit consolidation of shares or voting rights beyond 15% up to 55%, provided the acquirer does not acquire more than 5% of shares or voting rights of the target company in any financial year. [Regulation 11(1) of the SEBI Takeover Regulations] However, acquisition of shares or voting rights beyond 26% would apparently attract the notification procedure under the Act. It should be clarified that notification to CCI will not be required for consolidation of shares or voting rights permitted under the SEBI Takeover Regulations. Similarly the acquirer who has already acquired control of a company (say a listed company), after adhering to all requirements of SEBI Takeover Regulations and also the Act, should be exempted from the Act for further acquisition of shares or voting rights in the same company.

V  The Indian Income Tax Act (ITA), 1961

Merger has not been defined under the ITA but has been covered under the term 'amalgamation' as defined in section 2(1B) of the Act. To encourage restructuring, merger and demerger has been given a special treatment in the Income-tax Act since the beginning. The Finance Act, 1999 clarified many issues relating to Business Reorganizations thereby facilitating and making business restructuring tax neutral. As per Finance Minister this has been done to accelerate internal liberalization. Certain provisions applicable to mergers/demergers are as under: Definition of Amalgamation/Merger — Section 2(1B). Amalgamation means merger of either one or more companies with another company or merger of two or more companies to form one company in such a manner that:

i. All the properties and liabilities of the transferor company/companies become the properties and liabilities of Transferee Company.

ii. Shareholders holding not less than 75% of the value of shares in the transferor company (other than shares which are held by, or by a nominee for, the transferee company or its subsidiaries) become shareholders of the transferee company.
The following provisions would be applicable to merger only if the conditions laid down in section 2(1B) relating to merger are fulfilled:

a) Taxability in the hands of Transferee Company — Section 47(vi) & section

   a. The transfer of shares by the shareholders of the transferor company in lieu of shares of the transferee company on merger is not regarded as transfer and hence gains arising from the same are not chargeable to tax in the hands of the shareholders of the transferee company. [Section 47(vii)]

b) In case of merger, cost of acquisition of shares of the transferee company, which were acquired in pursuant to merger will be the cost incurred for acquiring the shares of the transferor company. [Section 49(2)]

VI Mandatory permission by the courts

Any scheme for mergers has to be sanctioned by the courts of the country. The company act provides that the high courts of the respective states where the transferor and the transferee companies have their respective registered offices have the necessary jurisdiction to direct the winding up or regulate the merger of the companies registered in or outside India.

The high courts can also supervise any arrangements or modifications in the arrangements after having sanctioned the scheme of mergers as per the section 392 of the Company Act. Thereafter the courts would issue the necessary sanctions for the scheme of mergers after dealing with the application for the merger if they are convinced that the impending merger is “fair and reasonable”.

The courts also have a certain limit to their powers to exercise their jurisdiction which have essentially evolved from their own rulings. For example, the courts will not allow the merger to come through the intervention of the courts, if the same can be effected through some other provisions of the Companies Act; further, the courts cannot allow for the merger to proceed if there was something that the parties themselves could not agree to; also, if the
merger, if allowed, would be in contravention of certain conditions laid down by the law, such a merger also cannot be permitted. The courts have no special jurisdiction with regard to the issuance of writs to entertain an appeal over a matter that is otherwise “final, conclusive and binding” as per the section 391 of the Company act.

VII Stamp duty

Stamp act varies from state to State. As per Bombay Stamp Act, conveyance includes an order in respect of amalgamation; by which property is transferred to or vested in any other person. As per this Act, rate of stamp duty is 10 per cent.

3.9 PROCEDURE FOR MERGER AND AMALGAMATION

Procedure for merger and amalgamation is different from takeover. Mergers and amalgamations are regulated under the provisions of the Companies Act, 1956 whereas takeovers are regulated under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations.

The beginning to amalgamation may be made through common agreements between the transferor and the transferee but mere agreement does not provide a legal cover to the transaction unless it carries the sanction of company court for which the procedure laid down under section 391 of the Companies Act should be followed for giving effect to amalgamation through the statutory instrument of the court’s sanction.

Although chapter V of the Companies Act, 1956 comprising sections 389 to 396-A deals with the issue and related aspects covering arbitration, compromises, arrangements and reconstructions but at different times and under different circumstances in each case of merger and amalgamation application of other provisions of the Companies Act, 1956 and ruled made there-under may necessarily be attracted. So, the procedure does not remain simple or literally confined to chapter V.
The procedure is complex, involving not only the compromises or arrangements between the company and its creditors or any class of them or between the company and its members or any class of them but it involves, safeguard of public interest and adherence to public policy. These aspects are looked after by the Central Government through official liquidator on Company Law Board, Department of Company Affairs and the court has to be satisfied of the same.

**Top management’s commitments towards merger and amalgamation**

Top management defines the organization’s goal and outlines the policy framework to achieve these objectives. The organization’s goal for business expansion could be accomplished, inter alia through business combinations assimilating a target corporate which can remove the present deficiencies in the organization and can contribute in the required direction to accomplish the goal of business expansion through enhanced commercial activity i.e. supply of inputs and market for output product diversification, adding up new products and improved technological process, providing new distribution channels and market segments, making available technical personnel and experienced skilled manpower, research and development establishments etc. depending upon the specific need and cost advantage with reference to creating a new set up or acquiring a well-established set-up firm.

**Search for a merger partner**

The top management may use their own contacts with competitors in the same line of economic activity or in the other diversified field which could be identified as better merger partners or may use the contacts of merchant bankers, financial consultants and other agencies in locating suitable merger partners. A number of corporate candidates may be shortlisted and identified. Such identification should be based on the detailed information of the merger partners collected from published and private sources. Such information should reveal the following aspects viz:

1) Organizational history of business and promoters and capital structure
2) Organizational goals
3) Product, market and competitors
4) Organizational setup and management pattern
5) Assets profile: Movable and immovable assets, land and building

6) Manpower – skilled, unskilled, technical personnel’s and detailed particulars of management employees.

**Negotiations**

Top management can negotiate at a time with several identified shortlisted companies suited to be merger partner for setting terms of merger and pick up one of them which offer most favorable terms.

Negotiations can be had with target companies before making any acquisitional attempt. Same drill of negotiations could be followed in the cases of merger and amalgamation.

Appendix II provides activity schedule for planning merger covering different aspects like preliminary consultations with the perspective merger partner and seeking its willingness to cooperate in investigations. There are other aspects, too, in the activity schedule covering, quantification action plan, purpose, shape, and date of merger, profitability and valuation, taxation aspects legal aspects and development plan of the company after merger.

**Steps for merger and amalgamation**

Once the merger partner has been identified and terms of merger are settled the procedure summarized in Appendix III can be followed. An explanation to the said steps is given below:

1. **Scheme of amalgamation**
   - The scheme of amalgamation should be prepared by the companies, which have arrived at a consensus to merge. There is no specific form prescribed for scheme of amalgamation but scheme should generally contain the following information:
   1. Particulars about transferee and transferor companies
   2. Appointed date
   3. Main terms of transfer of assets from transferor to transferee with power to execute on behalf or for transferee the deed or documents being given to transferee.
4. Main terms of transfer liabilities from transferor to transferee covering any conditions attached to loans/debentures/bonds/other liabilities from bank/financial institution/trustees and listing conditions attached thereto.

5. Effective date when the scheme will come into effect

6. Conditions as to carrying on the business activities by transferor between ‘appointed date’ and ‘effective date’.

7. Description of happenings and consequences of the scheme coming into effect on effective date.

8. Share capital of transferor company specifying authorized capital, issued capital and subscribed and paid up capital


10. Description of proposed share exchange ratio, any conditions attached thereto, any fractional share certificates to be issued, a transferee company’s responsibility to obtain consent of concerned authorities for issue and allotment of shares and listing.

11. Surrender of shares by shareholder of a transferor company for exchange into new share certificates.

12. Conditions about payment of dividend, ranking of equity shares, pro rata dividend declaration and distribution.

13. Status of employees of the transferor companies from effective date and the status of the provident fund, gratuity fund, super annuity fund or any special scheme or funds created or existing for the benefit of the employees.

14. Treatment on effective date of any debit balance of transferor company balance sheet.

15. Miscellaneous provisions covering income-tax dues, contingencies and other accounting entries deserving attention or treatment.

16. Commitment of transferor and transferee companies towards making applications/petitions under section 391 and 394 and other applicable provisions of the Companies Act, 1956 to their respective High Courts.

17. Enhancement of borrowing limits of the transferee company upon the scheme coming into effect.
18. Transferor and transferee companies give assent to change in the scheme by the court or other authorities under the law and exercising the powers on behalf of the companies by their respective Boards.

19. Description of powers of delegate of transferee to give effect to the scheme.

20. Qualification attached to the scheme, which requires approval of different agencies, etc.

21. Description of revocation/cancellation of the scheme in the absence of approvals qualified in clause 20 above not granted by concerned authorities.

22. Statement to bear costs etc. in connection with the scheme by the transferee company.

[2] Approval of Board of Directors for the scheme

Respective Board of Directors for transferor and transferee companies are required to approve the scheme of amalgamation.

[3] Approval of the scheme by specialised financial institutions/banks/trustees for debenture holders

The Board of Directors should in fact approve the scheme only after it has been cleared by the financial institutions/banks, which have granted loans to these companies or the debenture trustees to avoid any major change in the meeting of creditors to be convened at the instance of the Company Court’s under section 391 of the Companies Act, 1956.

Approval of Reserve Bank of India is also needed where the scheme of amalgamation contemplates issue of share/payment of cash to non-resident Indians or foreign national under the provisions of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000.

In particular, regulation 7 of the above regulations provide for compliance of certain conditions in the case of scheme of merger or amalgamation as approved by the court.

[4] Intimation to Stock Exchange about proposed amalgamation

Listing agreements entered into between company and stock exchange require the company to communicate price-sensitive information to the stock exchange immediately and simultaneously when released to press and other electronic media on conclusion of Board meeting according approval to the scheme.
[5] Application to Court for directions

The next step is to make an application under section 39(1) to the High Court having jurisdiction over the Registered Office of the company, and the transferee company should make separate applications to the High Court. The application shall be made by a Judge’s summons in Form No. 33 supported by an affidavit in Form No. 34 (see rule 82 of the Companies (Court) rules, 1959). The following documents should be submitted with the Judge’s summons:

(a) A true copy of the Company’s Memorandum and Articles

(b) A true copy of the Company’s latest audited balance sheet

(c) A copy of the Board resolution, which authorizes the Director to make the application to the High Court.

[6] High Court directions for members’ meeting

Upon the hearing of the summons, the High Court shall give directions fixing the date, time and venue and quorum for the members’ meeting and appoint an Advocate Chairman to preside over the meeting and submit a report to the Court. Similar directions are issued by the court for calling the meeting of creditors in case such a request has been made in the application.

[7] Approval of Registrar of High Court to notice for calling the meeting of members/creditors

Pursuant to the directions of the Court, the transferor as well as the transferee companies shall submit for approval to the Registrar of the respective High Courts the draft notices calling the meetings of the members in Form No. 36 together with a scheme of arrangements and explanations, statement under section 393 of the Companies Act and form of proxy in Form No. 37 of the Companies (Court) Rules to be sent to members along with the said notice. Once the Registrar has accorded approval to the notice, it should be got signed by the Chairman appointed for meeting by the High Court who shall preside over the proposed meeting of members.

[8] Dispatch of notices to members/ shareholders

Once the notice has been signed by the chairman of the forthcoming meeting as aforesaid it could be dispatched to the members under certificate of posting at
least 21 days before the date of meeting (Rule 73 of Companies (Court) Rules, 1959).

[9] Advertisement of the notice of members’ meetings

The Court may direct the issuance of notice of the meeting of these shareholders by advertisement. In such case rule 74 of the Companies (Court) Rules provides that the notice of the meeting should be advertised in; such newspaper and in such manner as the Court might direct not less than 21 clear days before the date fixed for the meeting. The advertisement shall be in Form No. 38 appended to the Companies (Court) Rules. The companies should submit the draft for the notice to be published in Form No. 38 in an English daily together with a translation thereof in the regional language to the Registrar of High Court for his approval. The advertisement should be released in the newspapers after the Registrar approves the draft.

[10] Confirmation about service of the notice

Ensure that at least one week before the date of the meeting, the Chairman appointed for the meeting files an Affidavit to the Court about the service of notices to the shareholders that the directions regarding the issue of notices and advertisement have been duly complied with.

[11] Holding the shareholders’ general meeting and passing the resolutions

The general meeting should be held on the appointed date. Rule 77 of the Companies (Court) Rules prescribes that the decisions of the meeting held pursuant to the court order should be ascertained only by taking a poll. The amalgamation scheme should be approved by the members, by a majority in number of members present in person or on proxy and voting on the resolution and this majority must represent at least ¾ in value of the shares held by the members who vote in the poll.

[12] Filing of resolutions of general meeting with Registrar of Companies

Once the shareholders general meeting approves the amalgamation scheme by a majority in number of members holding not less than 3/4 in value of the equity shares, the scheme is binding on all the members of the company. A copy of the
resolution passed by the shareholders approving the scheme of amalgamation should be filed with the Registrar of Companies in Form No. 23 appended to the Companies (Central Government’s) General Rules and Forms, 1956 within 30 days from the date of passing the resolution.

[13] Submission of report of the chairman of the general meeting to Court

The chairman of the general meeting of the shareholders is required to submit to the Court within seven days from the date of the meeting a report in Form No. 39, Companies (Court) Rules, 1959 setting out therein the number of persons who attend either personally or by proxy, and the percentage of shareholders who voted in favor of the scheme as well as the resolution passed by the meeting.

[14] Submission of Joint petition to court for sanctioning the scheme

Within seven days from the date on which the Chairman has submitted his report about the result of the meeting to the Court, both the companies should make a joint petition to the High Court for approving the scheme of amalgamation. This petition is to be made in Form No. 40 of Companies (Court) Rules. The Court will fix a date of hearing of the petition. The notice of the hearing should be advertised in the same papers in which the notice of the meeting was advertised or in such other newspapers as the Court may direct, not less than 10 days before the date fixed for the hearing (Rule 80 of Companies (Court) Rules).

[15] Issue of notice to Regional Director, Company Law Board under section 394 – A

On receipt of the petition for amalgamation under section 391 of Companies Act, 1956 the Court will give notice of the petition to the Regional Director, Company Law Board and will take into consideration the representations, if any, made by him.

[16] Hearing of petition and confirmation of scheme

Having taken up the petition by the Court for hearing it will hear the objections first and if there is no objection to the amalgamation scheme from Regional Director or from any other person who is entitled to oppose the scheme, the Court may pass an order approving the scheme of amalgamation in; Form No. 41 or
Form No. 42 of Companies (Court) Rules. The court may also pass order directing that all the property, rights and powers of the transferor company specified in the schedules annexed to the order be transferred without further act or deed to the transferee company and that all the liabilities and duties of the transferor company be transferred without further act or deed.

[17] **Filing of Court order with ROC by both the companies**

Both the transferor and transferee companies should obtain the Court’s order sanctioning the scheme of amalgamation and file the same with ROC with their respective jurisdiction as required vide section 394(3) of the Companies Act, 1956 within 30 days after the date of the Court’s order in Form No. 21 prescribed under the (Central Government’s) General Rules and Forms, 1956. The amalgamation will be given effect from the date on which the High Court’s order is filed with the Registrar.

[18] **Transfer of the assets and liabilities**

Section 394(2) vests power in the High Court to order for the transfer of any property or liabilities from transferor company to transferee company. In pursuance of and by virtue of such order such properties and liabilities of the transferor shall automatically stand transferred to transferee company without any further act or deed from the date the Court’s order is filed with ROC.

[19] **Allotment of shares to shareholders of transferor company**

Pursuant to the sanctioned scheme of amalgamation, the shareholders of the transferor company are entitled to get shares in the transferee company in the exchange ratio provided under the said scheme. There are three different situations in which allotment could be given effect:

1) Where transferor company is not a listed company, the formalities prescribed under listing agreement do not exist and the allotment could take place without setting the record date or giving any advance notice to shareholders except asking them to surrender their old share certificates for exchange by the new ones.

2) The second situation will emerge different where a transferor company is a listed company. In this case, the stock exchange is to be intimated of the
record date by giving at least 42 days notice or such notice as provided in the listing agreement.

3) The third situation is where allotment to Non-Resident Indians is involved and permission of Reserve Bank of India is necessary. The allotment will take place only on receipt of RBI permission. In this connection refer to regulations 7, 9 and 10B of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 as and where applicable.

Having made the allotment, the transferee company is required to file with ROC with return of allotment in Form No. 2 appended to the Companies (Central Government’s) General Rules and Forms within 30 days from the date of allotment in terms of section 75 of the Act.

Transferee company shall having issued the new share certificates in lieu of and in exchange of old ones, surrendered by transferor’s shareholders should make necessary entries in the register of members and index of members for the shares so allotted in terms of sections 150 and 151 respectively of the Companies Act, 1956.

[20] **Listing of the shares at stock exchange**

After the amalgamation is effected, the company which takes over the assets and liabilities of the transferor company should apply to the Stock Exchanges where its securities are listed, for listing the new shares allotted to the shareholders of the transferor company.

[21] **Court order to be annexed to memorandum of transferee company**

It is the mandatory requirement vide section 391(4) of the Companies Act, 1956 that after the certified copy of the Court’s order sanctioning the scheme of amalgamation is filed with Registrar, it should be annexed to every copy of the Memorandum issued by the transferee company. Failure to comply with requirement renders the company and its officers liable to punishment.

[22] **Preservation of books and papers of amalgamated Co.**
Section 396A of the Act requires that the books and papers of the amalgamated company should be preserved and not be disposed of without prior permission of the Central Government.

[23] The Post merger secretarial obligations

There are various formalities to be complied with after amalgamation of the companies is given effect and allotment of shares to the shareholders of the transferor company is over.

These formalities include filing of returns with Registrar of Companies, transfer of investments of transferor company in the name of the transferee, intimating banks and financial institutions, creditors and debtors about the transfer of the transferor company’s assets and liabilities in the name of the transferee company, etc.

All these aspects along with restructuring of organization and management and capital are discussed in chapter relating to post-merger reorganization of a transferee company.

[24] Withdrawal of the Scheme not permissible

Once the scheme for merger has been approved by requisite majority of shareholders and creditors, the scheme cannot be withdrawn by subsequent meeting of shareholders by passing Resolution for withdrawal of the petition submitted to the court under section 391 for sanctioning the scheme.

[25] Cancellation of the scheme and order of winding-up

It was held by the Supreme Court in J.K (Bombay) (P) Ltd. Vs. New Kaiser-I-Hind that the effect of winding up order is that except for certain preferential payments provided in the Act, the property of the company is applied in satisfaction of its liabilities pari passu. Pari passu distribution is to be made in satisfaction of its liabilities as they exist at the commencement of the winding-up.

So long as the scheme is in operation and is binding on the company and its creditors, the rights and obligations of those on whom it is binding are undoubtedly governed by its provisions.

But once the scheme is cancelled under section 392(2) on the ground that it cannot be satisfactorily worked and a winding-up order passed such an order is deemed to
be for all purposes to be one made under section 433. It is not because as the scheme has been sanctioned under section 391 that a winding-up order under section 392 (2) cannot be made.

3.10 METHODS OF VALUATION RELATED TO MERGERS AND ACQUISITIONS

The methods of valuation associated with mergers and acquisitions can be broadly classified into the following types:

1) Market Based Method

In valuation of mergers and acquisitions with the help of market based method, the different attributes of the firm which is going to be acquired are compared with the similar types of attributes of other firms in the market. These firms (not the firm in question) normally have a market value that has been set up earlier. Furthermore, some other factors are to be taken into consideration before the comparison of the different attributes is done. First of all, which elements need comparison are to be distinguished and secondly, which are the firms that are going to act as comparables. Public sector corporations involved in the same type of industry (of the target firm) can be chosen as comparables. Nevertheless, if the target firm is not registered with a stock exchange or is relatively small in its size than the public sector corporations, comparing it with the public sector corporations may not be useful. In these circumstances, public and private databases are there and these are basically commercial databases. The other features that require to be compared are net earnings, gross revenue, and book value of assets. As soon as all the information has been gathered, a broad-based comparison is performed for obtaining the value of the target firm.

The market based method can be further categorized into the following types:

- Market multiple (or price-earnings ratio) of comparable firms for firms that are not listed
- Market capitalization of listed firms
2) Income Based Method

The income based method of valuation associated with mergers and acquisitions takes into account the net present value. The net present value of earnings that is going to be received in the future is taken into consideration through the implementation of a mathematical formula.

The income based method can be further classified into the following types:

✓ Cost to create technique
✓ Free cash flow/discounted cash flow method
✓ Capitalized earnings technique

3) Asset Based Method

This method of valuation related to mergers and acquisitions is applied while the target firm is running at a loss. In this kind of a situation, the valuation of the assets of the firm at loss is estimated. Besides this procedure, the income based method and market based method can also be applied. Valuation received with the help of these procedures may render small values. Nevertheless, there is a probability that these methods would produce the true condition of the assets of the target firm.

The asset based method can be further categorized into the following forms:

✓ Valuation of Intangible Assets
✓ Economic Book Value or Net Adjusted Asset Value
✓ Liquidation Value
3.11 METHOD OF FINANCING M&As DEAL

Mergers are generally differentiated from acquisitions partly by the way in which they are financed and partly by the relative size of the companies. Various methods of financing an Mergers & Acquisitions deal exist:

1] *Payment by cash.*

Such transactions are usually termed acquisitions rather than mergers because the shareholders of the target company are removed from the picture and the target comes under the (indirect) control of the bidder’s shareholders alone.

A cash deal would make more sense during a downward trend in the interest rates. Another advantage of using cash for an acquisition is that there tend to be lesser chances of EPS dilution for the acquiring company. But a caveat in using cash is that it places constraints on the cash flow of the company.

2] *Equity share Financing or exchange of shares*

It is one of the most commonly used methods of financing mergers. Under this method shareholders of the acquired company are given shares of the acquiring company. It results into sharing of benefits and earnings of merger between the shareholders of the acquired companies and the acquiring company. The determination of a rational exchange ratio is the most important factor in this form of financing merger. The actual net benefit to the shareholders of the two companies depends upon the exchange ratio and the price earning ratio of the companies. Usually, it is an ideal method of financing a merger in case of price earning ratio of the acquiring company is comparatively high as compared to that of the acquired company.

3] *Debt and preference share financing*

A company may also finance a merger through issue of fixed instruct bearing convertible debentures and convertible preference share being a fixed rate of dividend. The shareholders of the acquired company sometimes prefer such a mode of payment because of security of income along with an option of conversion into equity within a stated period. The acquiring company is also benefitted on account of lesser
or on dilution of earnings per share as well as voting/controlling power of its existing shareholders.

4] Deferred payment or earn-out plan

Deferred payments also known as earn-out plan is a method of making payments to the target firm which is being acquired in such a manner that only a part of the payment is made initially either in cash or securities. In addition to the initial payment, the acquiring company undertakes to make additional payments in future years if it is able of increase the earning after the merger or acquisition. It is known as earn out plan because the future payments are linked with the firms future earnings. This method helps the acquiring company to negotiate successfully with Target Company and also help in increasing the earning per share because of lesser number of shares being issued in the initial years. However, to make it successful, the acquiring company should be prepared to co-operate towards the growth and success of the target firm.

5] Leverage buy-out

A merger of a company which is substantially financed through debt is known as leveraged buy-out. Debt, usually, forms more than 70% of the purchase price. The shares of such a firm are concentrated in the hands of a few investors and are not generally, traded in the stock, exchange. It is known as leveraged buy-out because of the leverage provided by debt source of financing over equity. A leveraged buy-out is also called management buy-out (MBO). However, a leveraged buy-out may be possible only in case of a financially sound acquiring company which is viewed by the lenders as risk free.

6] Tender offer

Under this method, the purchaser, who is acquisitioned of some company, approaches the shareholders of the target firm directly and offers them a price (which is usually more than the market price) to encourage them sell their shares to them. It is a method that results into hostile or forced take over. The management of the target firm may also tender a counter offer at still a higher price to avoid the take over. It may also educate the shareholders by informing them that the accusation offer is not in the interest of the shareholders in the long run.
7] Hybrids

An acquisition can involve a combination of cash and debt or of cash and stock of the purchasing entity.

3.12 ACCOUNTING FOR MERGERS AND ACQUISITIONS

In India, Accounting Standard (AS) 14 “Accounting for Amalgamations” deals with the accounting to be made in the books of Transferee Company. This AS is applicable where the acquired company is dissolved and its separate entity ceased to exist and the purchasing company continues the business of acquired company.

As per AS-14 there are two types of amalgamations: (a) Amalgamation in the nature of Purchase and (b) Amalgamation in the nature of Merger. An amalgamation will be in the nature of Purchase if any of the conditions regarding amalgamation in the nature of merger is not satisfied. An amalgamation is in the nature of Merger if all the conditions as prescribed in AS-14 for it are satisfied.

**Accounting treatment for amalgamation in the nature of Merger**

- In preparing the Balance Sheet of transferee company after amalgamation, all the assets and liabilities of the transferor and transferee company will be added line by line except share capital.
- The difference between the purchase consideration paid by the transferee company to the transferor company and the share capital of the transferor company should be adjusted with reserves.
- If the purchase consideration is more than the share capital of the transferor company, then the excess shall be debited to reserves, if reverse is the case, then credited to reserves.

**Accounting treatment for amalgamation in the nature of Purchase**

- In the books of the transferee company assets and liabilities (except fictitious assets and reserves & surplus) shall be recorded at the value at which they are taken over by the transferee company from the transferor company.
✓ If the purchase consideration exceeds the net assets taken over (Net Assets = Agreed value of assets less agreed value of liabilities), the difference will be debited to Goodwill account which is to be amortized over a reasonable period of time generally not exceeding five years and if reverse is the case then the difference is credited to Capital Reserve.

✓ To fulfill the requirement of maintenance of Statutory Reserves, the transferee company maintains such reserves created by transferor company for some more years in its books by passing the following journal entry,

\[
\text{Statutory Reserve Account} \quad \text{Debited} \\
\text{To} \quad \text{Amalgamation Adjustment Account}
\]

The accounting treatment in the books of the transferor company is not a big issue. The assets and liabilities which are being taken over in the M&A transaction are to be reversed in its books i.e. assets are to be credited and liabilities are to be debited