CHAPTER - II
MERGERS AND ACQUISITIONS: A THEORETICAL FRAMEWORK

The objective of this chapter is to present a theoretical framework of mergers and acquisitions (M&A) covering a conceptual framework, merger movement and approaches to the study of pre-merger and post-merger performance evaluation. This chapter is divided into three sections. The first section discusses the conceptual framework of M&As. The second section highlights merger movement – Global and Indian Scenario and Indian Policy on M&As. The last section portrays different approaches used in this study to analyse the pre-merger and post merger performance evaluation.

SECTION - I
Mergers and Acquisitions: A Conceptual Framework

Merger is defined as a combination of two or more companies into a single company where one survives and the others lose their corporate existence.\(^1\) A merger can take place either as an amalgamation or absorption. Acquisition refers to acquisition of a certain block of equity capital of a company which enables the acquirer to exercise control over the affairs of the company.\(^2\) In this case there will be willingness of purchasing company and selling company.
The terms merger and acquisition are often used synonymously, despite the existence of legal differences. Their impact on the organizational and economic contexts are quite similar and hence they can be studied as one phenomenon. This approach is followed in this study.

Mergers and acquisitions may be classified into three categories viz. horizontal mergers, vertical mergers and conglomerate mergers.

**Horizontal merger** takes place when two or more corporate firms dealing in similar lines of activity combine together. The purpose of such merger is elimination or reduction in competition, empire building, putting an end to price cutting, economies of scale in production, research and development, marketing and management costs. Merger of ShriRam Fibres with CEAT Nylon tyres, Eicher Tractors Ltd., with Royal Enfield Motors Ltd., British Gas with Gujarath Gas and Tata Oil Mills Co. with Hindustand Lever Ltd., are the popular examples of horizontal mergers.

**Vertical merger** occurs when a firm acquires its ‘upstream’ and ‘down stream’ firms. In case of ‘upstream’ type of merger it extends to the suppliers of raw materials and in the case of ‘down stream’ type of merger it extends to those firms that sell eventually to the consumers. The aim of such merger is to lower buying cost of materials, lower distribution and selling expenses, assured supplies and market, increasing or creating barriers to entry for potential competitors.
Merger of Arvind Mills with Quest Apparels, Mobil Oil with Montgomery Ward (US) are popular examples of vertical mergers.

**Conglomerate merger** refers to the combination of two or more firms engaged in different or unrelated types of business activities. Such merger helps in diversification of risk. Merger of ESSAR group with Sterling Computers is a popular example of conglomerate merger.

The companies are restructuring their operations through M&A route with number of motives.

**Motives of Mergers and Acquisitions:**

The M&As activities are primarily the result of the following factors and strategies.⁵

1) Strategic Motives
2) Organizational Motives
3) Financial Motives

1) **Strategic Motives:**

a) **Growth and Diversification:** Growth and diversification are considered important corporate objectives. If a firm has decided to enter or expand in a particular industry, acquisition of a firm in that industry, rather than dependence on internal expansion, may offer several advantages like prevention of competitors, less risk and less cost, etc. This approach provides a quick and easy way for growth and diversification.
b) **Economies of Scale**: When two or more companies combine together, the larger volume of operations of the merged entity results in various economies of scale. These economies arise because of optimum utilization of combined production capacities, distribution channels, research and development facilities, data processing systems etc. It is found that economies of scale are more predominant in horizontal mergers as the same kind of resources are available in the merging companies which can be utilized intensively.

c) **Synergy**: Synergy is one of the prime motives that guides M&A. The word synergy is defined as "the integration of two or more organizations or substances, to produce a combined effect greater than their separate effect". Synergy is simply defined as 2+2=5 phenomenon. The value of the merged company will be greater than the sum of the value of the individual companies before merger. Symbolically:

\[ V(AB) > V(A) + V(B) \]

Where \( V(AB) \) = Value of the merged entity
\[ V(A) = \text{Independent value of company A} \]
\[ V(B) = \text{Independent value of company B} \]

The greater value is ultimately expected to result into higher earnings per share for the merged firm. There are two significant aspects of synergy: operating synergy and financial synergy. **Operating synergy** can result both from functional and transactional interrelationship. Functional interrelationship is based on intangible resources such as reputation, R&D sharing and advertising. In some cases, benefits accrue due to economies of scope and in others due to
economies of scale. **Financial synergy** can result from proper utilization of financial resources and effective investment policies. Such synergy helps to have better credit worthiness, reduces cost of capital, increases the debt capacity, price-earning ratio and value per share. Further, flotation costs will be low and capital may be raised easily.

d) **Concentrating on Core Competencies:** The restrictive licensing policy and rigorous provisions of MRTP Act followed before 1991 did not allow the large companies and business houses to grow and diversify into areas of their core competencies. They were required to diversify into totally unrelated areas for which licenses were available. With the recent liberalization policy of the government, these business groups have started to rationalize their portfolios of industrial units. Due to the pressure of increased competition, the Indian conglomerates are realizing the need to focus on their core competencies. They are also realizing the importance of strategic withdrawal from certain areas. **M&As help corporate sector to concentrate on their core competencies.**

e) **Avoiding Unhealthy Competition:** **M&As route** may help companies to avoid unhealthy competition in a situation where there are too many players aiming at a limited market.

f) **Consolidation of Capacities:** In the past, the government issued licenses to units with capacities much below the minimum economic size. This phenomenon was observed in many industries like steel, sugar, cement, paper, automobiles, tyres, detergents etc. The banks and financial institutions financed these small projects, but many of them
were incurring losses or earning marginal profits. Small units were not in a position to face competition and to adopt pollution control norms prescribed by the government. M&As help to consolidate these splintered capacities. Consolidation of capacities through M&As will enable firms to gain competitive strength in domestic as well as global markets.

g) New Market Entry: Advertisement and market promotion activities will be more cost effective if the organization has presence in many places. Taking away a new market from a competitor will be a costly affair. Therefore it is easy to enter new markets through M&As at reasonable cost and efforts.

h) New Product Entry: Entering into a new product market is somewhat difficult and time consuming effort. Companies with adequate resources can do well in new product market through M&As.

2. Organizational Motives:

a) Empire Building: The money power available with the top management of big corporate houses encourages the managers to explore the possibilities of M&As. Such houses would build big empires by creating large size enterprises through M&A. It will satisfy the ego of the entrepreneurs and the senior managers.

b) Retention of Managerial Talent: Human resources play an important role in the success of an enterprise. Managerial talents are considered essential and important. To assure growth it is essential to retain managerial talent. M&As help companies in this regard.
c) **Removal of Inefficient Management:** If the management of a firm is inefficient, the shareholders of such firm can remove the management by merging with another firm having efficient management. M&A is a quick remedy to replace inefficient management from an organization which has high product strength.

3. **Financial Motives:**

   a) **Tax planning:** If a healthy company acquires a sick unit through merger, it can avail of income tax benefits under sec. 72A of the Income Tax Act. The said section stipulates that, subject to the merger fulfilling certain conditions, the healthy company’s profits can be set off against the accumulated losses of the sick unit. The tax savings thus accruing to the healthy company must be used for revival of the sick unit.

   b) **Higher Debt Capacity:**

      A company could enhance its borrowing capacity significantly through merger. The merged entity may enjoy a higher debt capacity because the earnings of the merged firm are more stable than the independent firm. A high debt capacity helps to avail more tax advantage and thus higher value of the firm.

   c) **Reduction in Flotation Cost**

      When two or more firms merge, they can save flotation costs of future equity, preference and debenture issues. In general these costs decrease with the increase in size of the issue.
d) Lower Rate of Borrowings:

The M&As lead to creation of large size business houses. The consequence of large size, greater earning power and stability lead to reduction in the cost of borrowing for the merged firm. The reason for this is that the creditors of the merged firm enjoy better protection than the creditors of the merging firms independently.

SECTION - II
Merger Movement

Global Scenario

In developed countries corporate mergers and acquisitions are a regular feature. In USA, Japan, UK and European nations thousands of mergers and amalgamations are taking place every year as a combination and reconstruction of the business enterprises. Across the border, mergers and takeovers of even multinational companies are common in the developed countries.

United States

United States has witnessed five periods of merger activities referred to as "Merger Waves". Each wave has been dominated by a particular type of merger. All the merger movements occurred when the economy experienced sustained high growth rates and coincided with particular developments in the business environment.

a) The First Wave (1897–1904): The merger of the first wave consisted mainly of horizontal mergers which resulted in a near monopolistic
market structure. During this period large monopolies like General Electric, Eastman, Kodak etc, were created. More than 3000 companies disappeared as a result of merger and 2943 mergers were reported during the above period.8

b) **The Second Wave (1916–1929):** During this period there were many vertical integrations through mergers. The motives behind such mergers were to achieve technical gains, and production extension. In this period a total of 4600 mergers took place and 12000 firms from different industries disappeared.9 This period transformed monopoly market into oligopoly market.

c) **The Third Wave (1960–1969):** This period is known as a conglomerate merger period because most of the small and medium sized firms adopted a diversification strategy into business activities outside their traditional areas of interest. Defensive diversification was a strong motivation behind mergers. As many as 26514 mergers took place in the US economy during this period.10

d) **The Fourth Wave (1981–1989):** The unique characteristic of the fourth wave is the significant role of hostile mergers. The fourth wave was a period of mega mergers. Some of the largest firms in the world including the Fortune 500 Firms became the target of acquirers. Around 22808 mergers and acquisitions took place in this period.11 The motive behind such mergers was expansion and growth.

e) **The Fifth Wave (1992 – till date):** There was once again increased activity of mergers in 1992. Mega mergers continued and the companies sought to expand and mergers were seen as a quick and
efficient way to do so. The main objectives of M&As were economies of scale, entry into new markets and reduction in competition. There was a movement towards the oligopolistic market structure. Deregulation and technology changes led to high level of merger activity due to which 53322 M&As took place during this period from 1992 to 2001. The merger movement in USA from 1897-2001 has been presented in table 2.1.

Table – 2.1
Merger Movement in USA

<table>
<thead>
<tr>
<th>Merger waves</th>
<th>No.of M&amp;As transactions</th>
<th>Type of M&amp;A</th>
<th>Objectives</th>
<th>Market structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>First wave 1897-1904</td>
<td>2943</td>
<td>Horizontal</td>
<td>Growth, expansion, empire building, economies of scale</td>
<td>Monopolistic market</td>
</tr>
<tr>
<td>Second wave 1916-1929</td>
<td>4600</td>
<td>Vertical</td>
<td>Technical gains, production extension</td>
<td>Oligopolistic</td>
</tr>
<tr>
<td>Third wave 1960-1969</td>
<td>26514</td>
<td>Conglomerate</td>
<td>Diversification of activities</td>
<td>Oligopolistic</td>
</tr>
<tr>
<td>Fourth wave 1981-1989</td>
<td>22808</td>
<td>Hostile merger</td>
<td>Growth &amp; expansion, empire building</td>
<td>Oligopolistic</td>
</tr>
<tr>
<td>Fifth wave 1992-2001</td>
<td>53322</td>
<td>Horizontal</td>
<td>Economies of scale, entry into new markets, reduction in competition</td>
<td>Oligopolistic</td>
</tr>
</tbody>
</table>

United Kingdom (UK)

In UK mergers and takeovers are common activities of the enterprises. For this purpose a “City Code”, containing rules of games for mergers and takeover was adopted in the year 1968. Its primary objective was to develop healthy and fair practices and protect the interests of the investors and shareholders. Prior to introduction of ‘City Code’, a person had full freedom to acquire voting rights in a company in any proportion either through private deal or through purchase at stock market without any restrictions or regulation. The United Kingdom experienced thousands of M&As. During the period 1964 to 1975, 10273 M&As transactions were recorded (with nominal value 11093 £m). In the next stage during 1976 to 1985, 4808 M&As were reported (with nominal value of 23800 £m) and from 1986 to 1992 as many as 6924 M&As took place (with nominal value of 106700 £m).

Europe

One of the main elements of contemporary corporate restructuring in Europe was the boom in mergers and acquisitions. The run-up to the completion of the single European market in 1992 witnessed a wave of mergers within the European Union (EU), while this was followed by a dip in merger activities in the early to mid 1990s. In the past few years, the value of M&As have reached unprecedented levels, influenced in part by the process of European Economic and Monetary Union (EEMU). After the turn of the century European companies were engaged in takeover wars, pitting cross-border raiders
against national champions. During 1991 and 1999 the cross border mergers increased to ten times. European governments have been especially proactive of their national banks. So there have been few major cross-border mergers of financial institutions. Of late a host of factors are stimulating M&A activity: interest rates are low, equity prices are rebounding and the stronger euro makes non-euro-zone investments more attractive. After three years of pruning costs, reducing debt, and cleaning up their balance sheets, the firms across Europe are ready to start cutting deals again, through targeted acquisition strategies in other countries. Low rates have allowed companies to refinance debt and free up capital to fund expansion. Restructuring through M&As across Europe is gaining an increasingly high profile, as new laws and regulation came into place to achieve harmonization. Some major M&As in Europe are as follows: 

- Lufthansa and Swiss International Air Lines (2005).
- Arcelor is acquired by Mittal Steel (2006).
- Corus acquired by Tata Steel (2007).

**Japan**

Historically, Japanese acquisitions were done very privately and very quietly by one company taking over a financially distressed smaller company for the benefit of its employees. Japan’s internal
business culture is changing, not by leaps and bounds but slowly and steadily as Japanese companies began to see mergers and acquisitions within the country and cross border transactions as offering viable economic benefits. There are three basic factors which are responsible for M&As in Japan\textsuperscript{16} viz. (a) consolidation of corporate entities for survival and to minimize operating costs, (b) secondly large groups absorb the small and medium enterprises, (c) thirdly, to co-operate with international companies which can provide money and back-up. Most of the major banks and securities houses have developed mergers and amalgamation divisions to explore opportunities and work in intense competition. Japanese companies have been active both at overseas as well as domestic fronts. Most of the companies were active in M&As at domestic front viz., Sanyo Electric merged with its sales arm Tokyo Sanyo Electric, Mitsushita Electric Industrial Company merged with Mitsushita Electric Trading Company and Toyota Motor Corporation with Toyota Sales during 1987. Dai-lehi Bank and Kangyo Bank merged and formed a new bank DKB which is today world’s largest commercial bank in Japan\textsuperscript{17}. This trend continued during 1988 and onwards. The firms were also active in cross broder M&As. During 1985 and 1986 various mergers were effected by Morgan Stanley. Merchant bankers for Japanese enterprise Fuji Bank acquired Walter E. Heler., Sanwa Bank acquired Continental Illinois Leasing, etc., Table 2.2 highlights major M&As deals world wide by value (in Million US$) during the period 2000 – 2007.
Table – 2.2

Major Mergers and Acquisitions World Wide During 2000-2007

<table>
<thead>
<tr>
<th>Rank</th>
<th>Year</th>
<th>Purchaser</th>
<th>Purchased</th>
<th>Transaction value (in mil. USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2000</td>
<td>Fusion: America Online Inc. (AOL)</td>
<td>Time Warner</td>
<td>164,747</td>
</tr>
<tr>
<td>2</td>
<td>2007</td>
<td>Schwebend: Barclays Plc</td>
<td>ABN-AMRO Holding NV</td>
<td>90,839</td>
</tr>
<tr>
<td>3</td>
<td>2000</td>
<td>Glaxo Wellcome Plc</td>
<td>SmithKline Beecham Plc.</td>
<td>75,961</td>
</tr>
<tr>
<td>4</td>
<td>2004</td>
<td>Royal Dutch Petroleum Co.</td>
<td>Shell Transport &amp; Trading Co</td>
<td>74,559</td>
</tr>
<tr>
<td>5</td>
<td>2006</td>
<td>AT &amp; T Inc.</td>
<td>Bell South Corporation</td>
<td>72,041</td>
</tr>
<tr>
<td>6</td>
<td>2001</td>
<td>Comcast Corporation</td>
<td>AT &amp; T Broadband &amp; Internet Svcs</td>
<td>72,041</td>
</tr>
<tr>
<td>7</td>
<td>2004</td>
<td>Sanofi-Synthelabo SA</td>
<td>Aventis SA</td>
<td>60,243</td>
</tr>
<tr>
<td>8</td>
<td>2000</td>
<td>Spin-off: Nortel Networks Corporation</td>
<td></td>
<td>59,974</td>
</tr>
<tr>
<td>9</td>
<td>2002</td>
<td>Pfizer Inc.</td>
<td>Pharmacia Corporation</td>
<td>59,515</td>
</tr>
<tr>
<td>10</td>
<td>2007</td>
<td>JP Morgan Chase &amp; Co</td>
<td>Bank One Corp</td>
<td>58,761</td>
</tr>
</tbody>
</table>


Indian Scenario:

Pre-liberalization Era (1947–1990)

The year 1947 is the landmark in the history of India because the country got independence on the 15th August 1947. At that time the economic and social conditions were not good. The Government made
planned efforts to improve the situation and to achieve higher rate of economic growth. To achieve these objectives the government introduced various measures to ensure corporate activities result into achievement of the planned goal of higher rate of economic growth, maximum welfare of the society, prosperity and happiness of the Indian public. It is from this angle, the government prescribed various regulatory measures. Numerous restrictions were placed on corporate sector under various enactments viz, Monopolies and Restrictive Trade Practices Act (MRTP),1969 the Indian Companies Act 1956 and Foreign Exchange Regulation Act (FERA) 1973 and Industrial Licensing Policy to have control over the concentration of economic power, expansion, mergers, acquisitions etc., and to prevent unhealthy practices and economic evils entering into the system. All these measures were aimed at protecting the common interest and public welfare. During the licencing era, several companies had indulged in unrelated diversifications depending on the availability of the licences. The companies thrived in spite of their inefficiencies because of the total capacity in the industry was restricted due to licencing. The restrictions placed on corporate sector under various Acts remained in vague for over two decades proved incompatible and became hurdles in the economic development of the country.

Despite the above unfavourable economic condition, the corporate sector witnessed 121 takeovers and mergers during the period 1988-1990. There were many instances of corporate raids by Non Resident Indians (NRIs) as well as Indian industrial entrepreneurs
on domestic corporate undertakings. For example, NRI raids were made by Swaraj Paul, Sethi Groups, Hindujas, Chhabria Groups etc., on Indian corporates. On the other hand, the Indian Industrial groups viz. The Goenkas, Oberoi Group, Mahindra and Mahindra (M&M) etc., were active in takeover bids.

Post-liberalization Era

Keeping in mind the global economic developments, global competition, regulatory and technological changes, the Indian government took a timely and bold decision to liberalize the Indian economy and passed the Industrial Policy Resolution in 1991 and also removed restrictions by amending various sections and provisions of MRTP, Act 1969, Companies Act 1956, FERA 1973, Sick Industrial Companies Act (SICA) 1985 and Income Tax Act 1961. Delicencing Policy and Foreign Direct Investment (FDI) policy were also liberalized. This historical decision of liberalization of Indian economy, virtually allowed the Indian corporate sector to restructure the activities through various means like mergers and acquisitions, takeovers, strategic alliances, spin-offs, divestiture, privatization of public sector undertakings etc. Among them, M&As have been the principal tools of corporate restructuring and means of growth and expansion which also help to achieve strategic, organization and financial motives. Thus winds of M&As are blowing with a stronger force in Indian corporate sector during the post liberalization era. As a result, hundreds of M&As have taken place.
Trends in Mergers and Acquisitions in India

The Indian companies are becoming increasingly aggressive in M&A as they take advantage of the restructuring, changing the face of the formerly protected domestic industry. The era of liberalization and globalization have a desirable impact on the domestic companies, which are gearing up to take the challenge from multinational companies (MNCs) in high spirit. The number of M&As across different years is shown in table 2.3 and 2.4.

Table – 2.3

Mergers and Acquisitions During 1992 – 1995

<table>
<thead>
<tr>
<th>Year</th>
<th>No.of mergers &amp; acquisitions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>Over 100</td>
</tr>
<tr>
<td>1993</td>
<td>Over 200</td>
</tr>
<tr>
<td>1994</td>
<td>Over 300</td>
</tr>
<tr>
<td>1995</td>
<td>Over 400</td>
</tr>
</tbody>
</table>

Source: Subramanian S. (1996)\(^9\)

Table 2.3 shows that the number of M&A in the year 1992 was over 100 and in the subsequent years the number showed increasing trend. The number of M&As which have taken place in India during 1999-2000 to 2004-05 are given in table 2.4.
**Table - 2.4**

Trends in M&As During 1999 - 2000 to 2004 - 05

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of mergers</th>
<th>No. of acquisitions</th>
<th>Total M&amp;As</th>
<th>Acquisitions value (Rs. In crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999 - 2000</td>
<td>197</td>
<td>1202</td>
<td>1399</td>
<td>51013</td>
</tr>
<tr>
<td>2000 - 01</td>
<td>297</td>
<td>1108</td>
<td>1405</td>
<td>31162</td>
</tr>
<tr>
<td>2001 - 02</td>
<td>304</td>
<td>953</td>
<td>1257</td>
<td>30398</td>
</tr>
<tr>
<td>2002 - 03</td>
<td>381</td>
<td>842</td>
<td>1223</td>
<td>23553</td>
</tr>
<tr>
<td>2003 - 04</td>
<td>289</td>
<td>838</td>
<td>1127</td>
<td>35541</td>
</tr>
<tr>
<td>2004 - 05</td>
<td>242</td>
<td>785</td>
<td>1027</td>
<td>61106</td>
</tr>
<tr>
<td></td>
<td>1710</td>
<td>5228</td>
<td>7438</td>
<td>232773</td>
</tr>
</tbody>
</table>

Source: Compiled from various journals of M&As published by Centre for Monitoring Indian Economy (CMIE), Mumbai.

**Fig-2.1:** Trends in M&As during 1999 - 2000 to 2004 - 05

Source: Table No. 2.4
Table 2.4 indicates that during 1999-2000, 197 mergers and 1202 acquisitions transactions took place. The acquisition value amounted to Rs. 51013 crores. In the year 2000-01 as many as 297 mergers and 1108 acquisitions aggregating 1405 transactions were reported. In the subsequent years the number of mergers showed increasing trend whereas the number of acquisitions indicated downward trend.

Mega Mergers in India

In the protected environment of the 1970s and 1980s many Indian business houses diversified their activities too much. After liberalization of the economy, the domestic and international competition has forced them to re-focus on core business. So the Indian corporate sector has changed due to restructuring and consolidation. The companies are building global capacities, modernizing plants, and improving efficiencies, cutting costs through mergers and acquisitions route. Some largest and multi-pronged mergers reported in Indian context are as follows:

a) Merger of Piramal Health Care Ltd (PHL) with Nicholas Piramal India Ltd (NPIL) (1996)

This merger has two sides viz, the Boehringer – Mannheim India Ltd., Germany drug company, merged with NPIL effective from March 1, 1996 and PHL merged with NPIL effective from June 1, 1996. The aim of this merger was to achieve improvements in marketing, greater viability and product complementarily etc. The Piramal Health Care Companies have moved to the top 20 in 1994, top 10 in 1995 and now into top five in 1997.
b) Four Nirma Arms Merger (1996 – 97)\textsuperscript{21}

During 1996-97 Four Nirma group companies, viz. Nirma Detergent Ltd., (NDL), Nirma Soaps and Detergents Ltd., (NSDL), Shiva Soaps and Detergents Ltd., (SSDL) and Nirma Chemicals Ltd., (NCL) merged each other and created Nirma Ltd. The objective of this merger was to have strong and resilient corporate entity to beat domestic and global competition.

c) Indian Cement Industries (1997 – 1999)\textsuperscript{22}

The cement industry has become less fragmented due to the consolidation of capacity that began in 1996. Five major players are leading the consolidation drive. Larsen and Tubro (L&T) is the largest with a total capacity of 12 million tonnes per annum (mtpa), while Associated Cement Companies (ACC) is in second position with 10.5 mtpa. The others, Grasim (9.7 mtpa), the top five cement companies today account for 42% of total capacity of 109 million tons p.a and 46% of an estimated Rs. 250 bm in turnover. All the five major players acquired a number of cement companies in India during 1997 – 1999 for building global capacity and to face global competition through M&A route.

d) Merger of Three G.P. Goenka Firms

Merger of GP Goenka Groups Consolidated Fibres Company Ltd., and Star Paper Ltd., with another group firm National Rayon Corporation took place.

The merger between Reliance Industries Ltd., (RIL) and Reliance Petroleum Ltd., (RPL) in the year 2002 is the biggest ever merger in the Indian corporate world. This was the biggest merger in terms of sales Rs. 58516 crores, profit Rs. 4548 crores, networth Rs. 23492 crores, total assets Rs. 54279 crores, equity capital Rs. 5802 crores and reserves Rs. 14919 crores. The objective of this merger was to create an enterprise of truly global size to face domestic and international competition.


The case of SCICI and ICICI merger is a pace setting development. It was intended to strengthen network and create a "giant" in financial sector to meet the challenges of international competition as well as to follow international standards to meet huge demand for financial services. The merger has to enhance networth fund raising capacity and credibility. Another important motive behind merger was to reduce the volume of non-performing assets (NPA). During the post merger period 1996-97 the performance of the company improved. There was increase in the net profit, dividend per share, capital base, and return on assets.

Indian Policy on Mergers and Acquisitions

Mergers and acquisitions in India have not been uncommon despite an unfavourable economic environment that existed before liberalization in 1991. Mergers have been mostly in the spirit of law. The Companies Act of 1956 provides the procedure for friendly
amalgamations. Similarly, the Income Tax Act of 1961 provides incentive of carry forwarding losses to the merged company. However, the major hurdles for large companies were the Monopolies and Restrictive Trade Practices Act (MRTP) of 1969 and for foreign companies the Foreign Exchange and Regulation Act (FERA) of 1974. Hence, mergers and acquisitions were low in India.

The Government of India had made it mandatory by the MRTP Act for business groups (interconnected undertakings) commanding assets of Rs. 100 crore or more (Rs 20 crore or more from 1969 to 1985) to obtain prior approval of the central government for expansion, establishment of new undertakings, merger, amalgamation, takeover, and appointment of directors. The MRTP Act was restructured in 1991 and the requirement of prior approval has been eliminated. FERA restricted equity holding of a foreign company in Indian companies to 40 percent. This too has been relaxed by increasing the limit to 51 percent in most cases. In special cases it can be even more than 51 percent subject to the permission of the Foreign Investment Promotion Board (FIPB). These provisions have made it easy for companies, both Indian and foreign, to go in for mergers and acquisitions. Till February 20, 1997, two sets of regulations governed takeovers: Clause 40 (A and B) of the listing agreement and the Securities Exchange Board of India (SEBI) Takeover Code of 1994. Clause 40 provided for making a public offer to the shareholders of a company by any person who sought to acquire 10 percent (25 percent till it was revised in 1990) or more of the voting rights of the company.
Outlines of SEBI Takeover Code

According to the SEBI Takeover Code, as soon as the equity holding of the acquirer was about to cross the 5 per cent limit, there was a provision for mandatory disclosure to the target company and the stock exchanges. That duty continued till the holding was less than 10 percent. The moment the 10 percent threshold was likely to be crossed, the acquirer had to make a public offer through a merchant banker to purchase at least 20 percent of the capital of the target company at the market rate. This is to ensure the protection of the interest of every shareholder. As against this, management of the target company was restrained from asset stripping or issuing further securities. The role of shareholders is significantly important in takeover. It may happen that shareholders of the target company take the lead and mute witness to the takeover process. The acquirer’s disclosure and other duties cease with the crossing of the 75 percent threshold. The SEBI Takeover Code was criticized by various quarters for its insufficient comprehensiveness. Also this code coupled with Clause 40 (A and B) of the listing agreement had caused much confusion as there existed some inconsistency between the two legislations; there were, in addition, unaddressed gaps concerning takeovers.

The New Takeover Code

SEBI constituted a committee under the chairmanship of P.N. Bhagwati, former Chief Justice of the Supreme Court of India, to examine the areas of deficiencies in the existing regulations and to suggest amendments to make takeovers more fair, transparent, and
unambiguous. The Committee released the draft code on takeovers on August 28, 1996. The SEBI board finalized the new takeover code, based on the draft code on takeovers, with a few changes on January 30, 1997. This was notified on February 20, 1997 as Securities and Exchanges Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

The new regulations differ from the old one on certain important aspects. Preferential allotments to promoters have been specifically exempted from the requirement of public offer. "Change in control" has been made a ground for public offer. Open market acquisitions by the acquirer will be permitted during the offer period, subject to highest acquisition price being paid to shareholders under public offer. The minimum offer price shall be the highest of either the negotiated price, the six month average of highs and lows, or the price paid by the acquirer for buying shares in target company in the last 26 weeks. The acquirer will have to deposit or provide bank guarantees or securities with appropriate margins of 10 percent of total offer amount in an escrow account, which could be forfeited in the event of default. Directors of the target company will be allowed to make recommendations on the offer to shareholders, public offer could be revised to include upward revision of price and quantity of shares. Offer letters will not be required to be vetted by SEBI. The competitive bid can be announced within 21 days of the public announcement of the first offer. The original acquirer can withdraw or revise his offer within 14 days of the announcement of the competitive bid. If offer is
withdrawn, no fresh open offer will be allowed by the same acquirer for
the next six months. The acquirer of a holding company will be
required to make a public offer to shareholders of each of the companies
acquired through such an acquisition. The regulations permit creeping
acquisition up to 2 percent every year by acquirers holding not less than
10 percent but not more than 51 percent. Any purchase by a person
holding more than 51 percent would have to be in a transparent manner
through a public tender offer24.

Exit policy in India is yet to be relaxed. Eventually it will be
relaxed as it is the logical conclusion of the liberalization process. When
this is done, asset stripping would become easy. This coupled with the
latest regulations is likely to substantially increase the number of
mergers and acquisitions.

SECTION - III
Approaches to the Study of Pre-merger and Post-merger
Performance Evaluation

Corporate sector in India is restructuring its operations through
M&As, which is considered as a vehicle for achieving growth and
expansion. Through M&As process it is expected that the performance
of firms will improve after merger.

The approaches to the study of pre-merger and post-merger
performance evaluation of M&As designed for the study are portrayed
in chart No. 2.1.
### Chart – 2.1
Approaches to the Study of Pre-merger and Post-merger Performance Evaluation

<table>
<thead>
<tr>
<th>I. Analysis of pre and post merger profitability</th>
<th>II. Analysis of pre and post merger operating performance</th>
<th>III. Analysis of pre and post merger financial performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Gross Profit ratio.</td>
<td>1) Ratio of Cost of Goods Sold to Net Sales</td>
<td>1) Debt to Equity Ratio</td>
</tr>
<tr>
<td>2) Operating Profit Ratio</td>
<td>2) Ratio of Material Cost to Net Sales</td>
<td>2) Proprietary Ratio</td>
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<tr>
<td>3) Earnings Before Interest and Taxes to Net Sales Ratio</td>
<td>3) Ratio of Labour Cost to Net Sales</td>
<td>3) Times Interest Coverage Ratio</td>
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<td>4) Net Profit to Net Sales Ratio</td>
<td>4) Ratio of Manufacturing Expenses to Net Sales</td>
<td>4) Cash Coverage Ratio</td>
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<tr>
<td>5) Return on Total Assets</td>
<td>5) Ratio of Administration and Selling and Distribution Cost to Net Sales</td>
<td></td>
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<tr>
<td>6) Return on Capital Employed</td>
<td>6) Inventory Turnover Ratio</td>
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<td>7) Return on Equity</td>
<td>7) Average Holding Period</td>
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<td>8) Earning Per Share</td>
<td>8) Debtors' Turnover Ratio</td>
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<tr>
<td>9) Dividend Per Share</td>
<td>9) Average Collection Period</td>
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<td></td>
<td>10) Capital Employed Turnover Ratio</td>
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<td>11) Fixed Assets Turnover Ratio</td>
<td></td>
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<tr>
<td></td>
<td>12) Current Asset Turnover Ratio</td>
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</tbody>
</table>
It is clear from chart 2.1 that suitable approaches have been employed to evaluate the pre-merger and post-merger performance of sample units. These include (a) Analysis of pre-merger and post-merger profitability (b) Analysis of pre-merger and post merger operating performance and (c) Analysis of pre-merger and post-merger financial performance. Various ratios have been computed and applied to analyze the pre and post merger performance.

The discussion on pre-merger and post-merger performance evaluation in respect of profitability, operating and financial performance has been made in chapters 4, 5 and 6.

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