CHAPTER 3

CONCEPTUAL FRAMEWORK OF MERGER & ACQUISITION
<table>
<thead>
<tr>
<th>SR. No.</th>
<th>CONTENTS</th>
<th>PAGE No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>Introduction</td>
<td>43</td>
</tr>
<tr>
<td>3.2</td>
<td>Meaning and Definition of Merger</td>
<td>44</td>
</tr>
<tr>
<td>3.3</td>
<td>Types of Mergers</td>
<td>45</td>
</tr>
<tr>
<td></td>
<td>3.3.1 Merger through Absorption</td>
<td>45</td>
</tr>
<tr>
<td></td>
<td>3.3.2 Merger through Consolidation</td>
<td>45</td>
</tr>
<tr>
<td>3.4</td>
<td>History of Merger &amp; Acquisition</td>
<td>46</td>
</tr>
<tr>
<td></td>
<td>3.4.1 The First Merger Wave (1897-1904)</td>
<td>46</td>
</tr>
<tr>
<td></td>
<td>3.4.2 The Second Wave (1916-1929)</td>
<td>46</td>
</tr>
<tr>
<td></td>
<td>3.4.3 The Third Wave (1965-1970)</td>
<td>47</td>
</tr>
<tr>
<td></td>
<td>3.4.4 The Fourth Wave (1981-89)</td>
<td>47</td>
</tr>
<tr>
<td></td>
<td>3.4.5 The Fifth Wave (1992 Onwards)</td>
<td>47</td>
</tr>
<tr>
<td>3.5</td>
<td>Classification of Mergers</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td>3.5.1 Horizontal Merger</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td>3.5.2 Vertical Merger</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td>3.5.3 Conglomerate Merger</td>
<td>49</td>
</tr>
<tr>
<td>3.6</td>
<td>Concept of Acquisition</td>
<td>50</td>
</tr>
<tr>
<td>3.7</td>
<td>Difference between Merger and Acquisition</td>
<td>50</td>
</tr>
<tr>
<td>3.8</td>
<td>Motives behind Mergers and Acquisitions</td>
<td>51</td>
</tr>
<tr>
<td></td>
<td>3.8.1 Synergy</td>
<td>51</td>
</tr>
<tr>
<td></td>
<td>3.8.2 Technological Advancement</td>
<td>52</td>
</tr>
<tr>
<td></td>
<td>3.8.3 Improved Profitability</td>
<td>52</td>
</tr>
<tr>
<td></td>
<td>3.8.4 Attaining Competitive Edge</td>
<td>53</td>
</tr>
<tr>
<td></td>
<td>3.8.5 Exploring New Geographical Boundaries</td>
<td>53</td>
</tr>
<tr>
<td></td>
<td>3.8.6 Availability of Financial Resources</td>
<td>53</td>
</tr>
<tr>
<td></td>
<td>3.8.7 Tax Benefits</td>
<td>53</td>
</tr>
<tr>
<td>3.9</td>
<td>Top 10 M&amp;A Deals Worldwide By Value from 2000 To 2010</td>
<td>54</td>
</tr>
<tr>
<td>3.10</td>
<td>Other Notable M&amp;A Deals from 2010 To 2014</td>
<td>55</td>
</tr>
<tr>
<td>3.11</td>
<td>Top 10 Acquisitions Made By Indian Companies Worldwide</td>
<td>55</td>
</tr>
<tr>
<td>3.12</td>
<td>Accounting for Amalgamation – As 14</td>
<td>56</td>
</tr>
<tr>
<td>3.12.1</td>
<td>Amalgamation in the Nature of Merger</td>
<td>56</td>
</tr>
<tr>
<td>--------</td>
<td>-------------------------------------</td>
<td>----</td>
</tr>
<tr>
<td>3.12.2</td>
<td>Amalgamation in the Nature of Purchase</td>
<td>57</td>
</tr>
<tr>
<td>3.12.3</td>
<td>Methods of Accounting</td>
<td>57</td>
</tr>
<tr>
<td>3.12.4</td>
<td>Ind-As 103 Business Combinations</td>
<td>58</td>
</tr>
<tr>
<td>3.12.5</td>
<td>Scope</td>
<td>59</td>
</tr>
<tr>
<td>3.12.6</td>
<td>Reverse Acquisition</td>
<td>59</td>
</tr>
<tr>
<td>3.12.7</td>
<td>Method of Accounting</td>
<td>60</td>
</tr>
<tr>
<td>3.12.8</td>
<td>Steps In Acquisition Methods</td>
<td>60</td>
</tr>
<tr>
<td>3.12.9</td>
<td>Taxation Aspects of Amalgamation</td>
<td>61</td>
</tr>
<tr>
<td>3.12.10</td>
<td>Implications In Terms Of Capital Gains Tax</td>
<td>62</td>
</tr>
<tr>
<td>3.13</td>
<td>Legal and Regulatory Framework Of M&amp;A</td>
<td>64</td>
</tr>
<tr>
<td>3.13.1</td>
<td>Indian Companies Act, 1956</td>
<td>64</td>
</tr>
<tr>
<td>3.13.2</td>
<td>Foreign Exchange Management Act, 1999</td>
<td>65</td>
</tr>
<tr>
<td>3.13.3</td>
<td>The Competition Act, 2002</td>
<td>66</td>
</tr>
<tr>
<td>3.13.4</td>
<td>Foreign Exchange Management Act, 1999</td>
<td>67</td>
</tr>
<tr>
<td>3.13.5</td>
<td>SEBI Take Over Code 1994</td>
<td>67</td>
</tr>
<tr>
<td>3.13.6</td>
<td>Legal Procedure for Bringing About Merger of Companies</td>
<td>68</td>
</tr>
</tbody>
</table>
3.1 Introduction

The main objective of any company in the world is to grow. The growth here means the profit maximization and wealth maximization. It is been said that the wealth maximization take place with the increasing value of shareholders wealth. Growth is impossible without profitability of the business on the consistent base. A company has to bring its competitive edge up to certain level so that its existence cannot be question.

The emergence of buyers’ driven market that is putting pressure on the bottom line of companies, specifically increased competition and deregulation and liberalization in the developing economies like Asia, Latin America and Eastern Europe have undergone the sea changes in the context of development in the whole world.

This increased competition, deregulation, liberalization, privatization, advanced technology, awareness of customer; companies are finding it difficult to retain their market share. There are two types of problem lying in front of companies either to enhance or at least retain their volumes and maintaining, if not increasing their margins. Firms as defense strategy are adopting the strategies of diversification, corporate restricting, consolidation etc.

Mergers and acquisition have emerged as one of the most potent tool of corporate consolidation and restructuring. Firms are combining their businesses, their operations and trying to bring down their operating cost by achieving economies of scale, reducing internal competition and sustaining the financial position of both.

Mergers and acquisitions have gained importance in recent times. Business consolidation by large industrial houses, consolidation of business by multinationals operating in India, increasing competition amongst domestic companies and competition against imports have all combined to spur mergers and acquisitions activities in India.\(^{10}\)(Waghmare)

Mergers and acquisitions have is looked as long term investing decision from the view point of acquiring or merged firm as it provides such firms with productive

investment avenues to park their surpluses enhancing their expected future income. That is why the evaluation of merger is done like a capital budgeting decision.\(^\text{11}\) (Misra, 2011)

### 3.2 Meaning and Definition of Merger

Every business is guided by the goal of wealth maximization. The wealth can be maximized by either internal or external growth. Internal growth can be achieved through either product extension or capacity expansion. External growth can be achieved, inter-alia by merger and acquisitions of existing business firms. Such a route is termed as inorganic growth and is often seen as a faster way for firms to grow.\(^\text{12}\) (Misra, 2011)

According to the Oxford Dictionary, the term ‘merger’ means combining of two things, especially companies, to one.\(^\text{13}\) (Dictionary, 2002)

A merger is a strategy wherein two or more companies agree to combine their business operations. A combination of two or more businesses into one business is the merger. In this process one company survives and others lose their corporate existence. The survivor company acquires assets and liabilities of the merged company. In other words one company purchases another company for cash and integrates the purchased company with itself.

Merger refers to a situation when two or more existing companies combine together and form either a new company or any one of existing company survive and another existing company ceases to exit.

The Income Tax Act, 1961 [(Section 2(1A))] defines an amalgamation as the merger of one or more companies with another, or the merger of two or more companies to form a new company, in such a way that all assets and liabilities of the amalgamating companies become the assets and liabilities of the amalgamated company. Amalgamation is synonym of merger especially in Indian Law.


3.3 Types of Mergers

Merger may be of two forms:

1. Merger through Absorption and
2. Merger through Consolidation

3.3.1 Merger through Absorption: When two or more companies’ get merge into an existing company is called merger through absorption. In this type of merger one company ceases its existence, For example, in the absorption of Tata Fertilizers Ltd. by Tata Chemicals Ltd. Here, Tata Chemicals Ltd. was an acquiring company, survived after the merger and Tata Fertilizers Ltd. was an acquired company.

3.3.2 Merger through Consolidation: Consolidation is a combination of two or more companies into one ‘new company’. In such type of merger, all companies are legally dissolved and a new entity is created. The acquired company transfers its assets, liabilities and shares to the acquiring company for the consideration of cash or exchange of shares, For example, Hindustan Computes Ltd, Hindustan Instrument Ltd., and Indian Software Company Ltd and Indian Repographics Ltd merged into a new company called HCL Ltd.

As per Accounting Standard 14 issued y ICAI in 1994,’ amalgamation’ means an amalgamation pursuant to the provisions of the Companies Act, 1956 or any other statute that may be applicable to companies.

An amalgamation satisfies all the following conditions:

- After amalgamation, all the assets and liabilities of the transferor company become the assets and liabilities of the transferee company.
- Shareholders holding not less than 90% of the face value of the equity shares of the transferor company become equity shareholder of the transferee company by virtue of the amalgamation.
- The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may paid in respect of any fractional shares.
• The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.
• No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company, except to ensure uniformity of accounting policies.

3.4 History of Merger & Acquisition

There were many favorable economic factors led mergers and acquisitions in the Indian economy. Most of the mergers and acquisitions cases are the results of factors like growth in the GDP, higher interest rates and fiscal policies. India as a country and world as a whole has a rich history of Mergers and Acquisitions. It can help in gathering the historical moments, significant updates of mergers and acquisitions in the Indian economy. The study of mergers and acquisitions history helps the researcher to understand the merger wave carefully and in depth. Merger and Acquisitions history helps us to understand the evolution of the concepts of mergers and acquisitions in the world. The merger waves are as follows:

3.4.1 The First Merger Wave (1897-1904): This was an era of dominant players in the market in the sectors like electricity, railways etc. The tenure witnessed majority of mergers of horizontal nature. The significant contribution in the history of mergers and acquisition during this tenure was specifically of steel, metal and construction industries. Even though the majority of the mergers were of horizontal nature could not achieve the operational efficiency and failed due to absence of desired efficiency. The slowdown of economy in the year 1903 and stock market crash of 1904 added the reasons for failure of merger decisions. Even the legal framework was not supportive. Then the Supreme Court passed the mandate that the anticompetitive mergers could be halted using the Shareman Act.

3.4.2 The Second Wave (1916-1929): The first merger and acquisition wave concentrated on specifically the combinations of anti-competitive firms. The financial boom boosted the second wave after the First World War. The expansion further lead to developments in the fields of science and technology and the emergence of infrastructure firms which provided services for required growth in railroads and
transportation by automobiles. The government strategies laid in 1920s made the corporate atmosphere supportive enough for firms to work in harmony. Even the financial institutions like government and private banks have played a significant role in aiding the process of mergers and acquisitions. The mergers, which have taken place during 1916-1929, were horizontal or multinational in nature. The industries involved in this period were the manufacturers of metals, automobile tools, food commodities, chemicals etc. This phase ended in 1929 with a massive decline in stock market followed by great depression. However, the tax exemptions in 1940s encouraged the conglomerates to involve themselves in mergers and acquisitions.

3.4.3 The Third Wave (1965-1970): The majority of the mergers of this wave were horizontal in nature. They were triggered by elevating stock and interest rates, and stern implementation of anti-trust rules and regulations. During this phase, the bidding companies were small and even their economic strength was good than the target companies. These kinds of mergers were sponsored by equities as a result banks were thereby eliminating the roles of banks had no role to play as financier or for an investment purpose. In 1968, the Attorney General decided to break the multinationals, which resulted in the end of merging activities after that. The decision was triggered by the inefficient performance of the multinationals. In the year 1970, the emergence of mergers and acquisitions has been identified and the merged firms had contributed effectively to the economy.

3.4.4 The Fourth Wave (1981-89): The fourth was witnessed the acquisitions of the firms which were very big in size. Industries like oil and gas, pharmaceuticals, banking, aviation combined their business with their national and international counterparts. Cross border buyouts became regular with most of them being unfriendly in nature.

3.4.5 The Fifth Wave (1992 onwards): This period was moved by globalization, rise in stock market boom and deregulation policies. Major mergers were seen taking place between telecom and banking giants out of which most were sponsored by equities. The industrialist had opted for mergers and acquisition with the motto of long-term profitability. Even the conglomerates had taken initiative to participate in the process of merger and acquisition because of attractive motivational factors like hopeful economic trends, investments by corporate and revised government
policies etc. Therefore, we can conclude that as long as business entities exist and the economic factors are favorable, the trend of mergers and acquisitions will continue.

3.5 Classification of Mergers

3.5.1 Horizontal Merger: In case of horizontal merger, both the merging firm and the merged firm produce and sell identical or similar products in the same geographic area. So if the parties involved in a merger are in direct competition with each other it is termed as horizontal merger. The merger is based on assumption that it will provide synergy and allow enhanced cost efficiencies to the new business. Such combinations will give benefits such as staff reduction, decrease in cost, and economies of scale, opportunity to acquire new technologies unique to the Target Company, increased market share and industrial recognition.

For examples: The acquisition of Parle products by Coke, Merger of Brooke Bond India with Lipton India to form Brooke Bond Lipton India Ltd., merger of Daimler-Benz and Chrysler, GlaxoWellcome Plc. with SmithKline Beecham Plc. Volkswagen and Rolls Royce and Lamborghini etc.

3.5.2 Vertical Merger: A combination of two or more firms that fall in the same industry but operate at different stages of production distribution chain is termed as vertical merger. It is a merger of non-competitors companies. In vertical merger, the product of one company is either a necessary component or complement of other company. Vertical mergers are further classified as:

- **Market extension merger:** (Rajinder S. Aurora, 2011) This is a merger between two companies that sell the same products but in different markets.
- **Product extension merger:** (Rajinder S. Aurora, 2011) It is designed to increase the type/range of products that a company sells in a particular market. Such a merger occurs when two companies selling different but related products in the same market merge.

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• **Forward integration:** When a combines with the customer, it is called forward integration. Here, the target firm is involved in the next stages of production/operation. For example, the TV manufacturer merges with TV marketing company.

• **Backward integration:** When a company combines with the supplier of material, it is called backward integration. Here, the target company is involved in the previous stages of production/operation. For example the manufacturer of the product merges with the provider of raw materials.

• **Balanced integration:** This is a situation where the company sets up subsidiaries that both supply them with inputs and distribute their outputs.

A vertical merger is an important instrument available for the firms who want to move up or down the value chain. Vertical mergers can have very positive impact on production and inventory since information flows efficiently within the organization without any communication gaps. It helps companies to reduce the cost of inputs, distribution overheads and to pose entry barrier for the potential competitor. The examples of vertical mergers are Apple and Intel, Reliance Industries Limited and Reliance Petrochemicals Limited, Tata Industrial Finance Limited and Tata Finance, Hindustan Unilever Limited and Tata Oil Mills Co. (TOMCO), Torrent Group and Ahmedabad Electric Company, Surat Electric Company. The acquisition of German drug major Betapharm by Dr.Reddy’s Laboratories Ltd. Is an example of vertical integration as the acquisition is expected to give Dr.Reddy’s access to the supply chain of Betapharm into Germany and the rest of the Europe\(^\text{16}\). (Misra, 2011)

3.5.3 **Conglomerate Merger:** When two unrelated businesses merged, it is called conglomerate merger. These are the mergers wherein the businesses involved are neither competitors nor the part of the same supply chain. It simply means to say that they are not related either horizontally or vertically with each other. The US Supreme Court describes a conglomerate merger as ‘one in which there is no economic relationship between the acquiring and the acquired firm’.\(^\text{17}\) (Rajinder S.Aurora, 2011) The firms having planned to increase their product lines and interested in adding

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new areas to their existing portfolio of business are opting for conglomerate merger. The examples of conglomerate mergers are News Corporation, Sony, Time Warner, Walt Disney Company, Aditya Birla Group, Berkshire Hathways, General Motors, Mahindra Groups, Tata Group, Hyundai and Mitsubishi etc.

### 3.6 Concept of Acquisition

If one company acquires the controlling interest in another company, it is called acquisition. Acquisition is an attempt made by one firm to gain a majority interest in another firm. The company who acquires the majority share is called acquiring firm and the other firm is called target firm. After completing the acquisition procedure, the acquiring firm becomes the legal owner and controller of the business of the target firm. Companies prefer the option of acquisition for achieving economies of scale, increased efficiency, and market enhanced visibility. In case of an acquisition, if the controlling interest in a company is bought without the consent of its management, it is known as takeover. In the cases where the things become hostile, it would be hostile takeover and if both the management of the company mutually completes with negotiation, it will be friendly takeover.

### 3.7 Difference between Merger and Acquisition

It is observed that even mergers and acquisitions are two different words having their own meaning are often spoken as they are synonymous.

- **What is Merger?**

A merger occurs when two or more firms decide to merge with each other and any one of them loses its existence. They decide to take their combined business ahead instead of operating their individual business separately. All mergers are the formal transactions as they have to follow the guidelines of law or statute of the state wherein the company is operating their business.

- **What is Acquisition?**

Acquisition takes place when the business of one company is taken over by another company and the second company establishes itself as the new company.
**Difference between Merger and Acquisition:**

In case of merger, two firms come together and form a new firm. After merger the two separate firms become a single firm. The firms combine the businesses of both and forms a new firm and run the business jointly is called merger. The stocks of old companies are surrendered and the stocks of new firm are distributed to the shareholders of the new company.

In case of acquisition, the business of one company is swallowed by another company and after acquisition the acquired company loses its existence and the acquiree company establishes its ownership on the acquired company and its business. In other words, the acquired company is smaller in size comparatively to the Acquiree Company. The stocks of acquired company are not surrendered to the AcquireeCompany. The shares of the Acquiree Company are still traded in the stock market in the ownership of acquired company.

Normally when the deal between two companies done on the friendly basis, it is proclaimed as merger and when one company swallows the business of another company without the consent of Target Company is acquisition.

For example, Glaxo Wellcome and SmithKline Beehcam ceased to exist and merged to become a new company, known as Glaxo SmithKline.

In addition, Dr.Reddy’s Labs acquired Betapharm through an agreement amounting $597million.

**3.8 Motives behind Mergers and Acquisitions**

There are various reasons for the companies to get merged or to acquire a controlling stake in another company. To specify there are following reasons for mergers and acquisitions.

**3.8.1 Synergy:** Synergy is the most essential component of mergers. Synergy means value addition out of the particular deal. In mathematics $2+2=4$ but in case of mergers and acquisitions, it would be rather it should be 5 or much more than that. Synergy occurs in the form of revenue enhancement and cost savings. For example, if firm A and firm B
Merged with and value of combined firm would be $V(AB)$ is expected to be greater than $(VA+VB)$. That means the sum of the independent values of A and B the combined entity is said to benefitting through synergy. There are operating synergy and financial synergy. Operating synergy takes place when there is a cost saving out of economies of scale or increased sale and profit. And financial synergy will have direct reflection on the financial factors such as lower taxes, higher debt capacity or better use of idle cash. The following are the examples of synergy. (Rajinder S.Aurora, 2011)

- When HUL acquired Lakme, it helped HUL to enter the cosmetics market through an established brand.
- When Glaxo and Smith Kline Beecham merged, they not only gained market share but also eliminated competition between each other.
- Tata Tea acquired Tetley to leverage Tetley’s international marketing strengths.

3.8.2 Technological advancement: To survive in the cutthroat competition, companies need to constantly upgrade their technology and business applications. Merger and acquisition are helpful in such case because the companies need not always acquire new technologies. By acquiring another company with the upgraded technology, unique technological advancements, the competitive edge can be maintained.

3.8.3 Improved profitability: The result of the International Business Owners Survey 2004 carried out Grant Thompson, conducted across 26 countries in Europe, Africa, Asia Pacific and US, showed that 34% of businesses use merger and acquisition to maintain or improve profitability. (Rajinder S.Aurora, 2011) Whenever the company observes an opportunity of increased profitability, they opt for the decision of merger and acquisition. Merger and acquisition aims at reduction of cost by achieving economies of scale. It means achieving operational efficiency which will ultimately lead at improved profitability.

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3.8.4 **Attaining competitive edge**: Attaining competitive edge here means making company capable enough to survive in the competition from domestic and foreign market as well. Merger and acquisition will be helpful to the companies to attain the competitive edge from the target firm so that instead of competing each other it is better to try to enjoy the market leadership.

3.8.5 **Exploring new geographical boundaries**: In the normal route of new market entry, company may face a stiff competition from existing leaders into the market. And again the investment of huge capital requirement would be the question to be answered. If the strategic entry with merger or acquisition is done, there can be easy entry into the new market and can enjoy the market leadership of the existing players by joining hands together with it. For example, merger of Orange, Hutch and Vodafone took place to achieve this objective.

3.8.6 **Availability of financial resources**: It would be difficult for the corporate to procure funds from capital market quiet often. Here, the company that is rich financially will be targeted to merge with to take an advantage of unused financial resources.

3.8.7 **Tax benefits**: It is one of the motives for merger and acquisition decisions. By targeting loss-making companies, the profit of the acquiring company can be set off against the accumulated losses of Target Company. The strategy is adopted to reduce tax liability. Ashok Leyland Information Technology (ALIT) was acquired by Hinduja Finance, a group company, so that it could set off the accumulated losses in ALITs books against it profit.
3.9 Top 10 Mergers & Acquisitions Deals Worldwide By Value from 2000 To 2010

<table>
<thead>
<tr>
<th>Rank</th>
<th>Year</th>
<th>Purchaser</th>
<th>Purchased</th>
<th>Transaction value (in USD)</th>
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<tbody>
<tr>
<td>1</td>
<td>2000</td>
<td><em>Fusion</em>: AOL Inc. (America Online)</td>
<td>Time Warner</td>
<td>164,747,000,000</td>
</tr>
<tr>
<td>2</td>
<td>2000</td>
<td>GlaxoWellcome Plc.</td>
<td>SmithKline Beecham Plc.</td>
<td>75,961,000,000</td>
</tr>
<tr>
<td>3</td>
<td>2004</td>
<td>Royal Dutch Petroleum Company</td>
<td>&quot;Shell&quot; Transport &amp; Trading Co.</td>
<td>74,559,000,000</td>
</tr>
<tr>
<td>4</td>
<td>2006</td>
<td>AT&amp;T Inc.</td>
<td>BellSouth Corporation</td>
<td>72,671,000,000</td>
</tr>
<tr>
<td>5</td>
<td>2001</td>
<td>Comcast Corporation</td>
<td>AT&amp;T Broadband</td>
<td>72,041,000,000</td>
</tr>
<tr>
<td>6</td>
<td>2009</td>
<td>Pfizer Inc.</td>
<td>Wyeth</td>
<td>68,000,000,000</td>
</tr>
<tr>
<td>7</td>
<td>2000</td>
<td><em>Spin-off</em>: Nortel Networks Corporation</td>
<td></td>
<td>59,974,000,000</td>
</tr>
<tr>
<td>8</td>
<td>2002</td>
<td>Pfizer Inc.</td>
<td>Pharmacia Corporation</td>
<td>59,515,000,000</td>
</tr>
<tr>
<td>9</td>
<td>2004</td>
<td>JPMorgan Chase &amp; Co.</td>
<td>Banc One Corporation</td>
<td>58,761,000,000</td>
</tr>
<tr>
<td>10</td>
<td>2008</td>
<td>InBev Inc.</td>
<td>Anheuser-Busch Companies, Inc.</td>
<td>52,000,000,000</td>
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(Source: [http://en.wikipedia.org/wiki/Mergers_and_acquisitions](http://en.wikipedia.org/wiki/Mergers_and_acquisitions))

Table: 3.1 Top 10 Mergers & Acquisitions Deals Worldwide
### 3.10 Other Notable M&A Deals from 2010 To 2014

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<th>Year</th>
<th>Purchaser</th>
<th>Purchased</th>
<th>Transaction value (in USD)</th>
</tr>
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<tbody>
<tr>
<td>2011</td>
<td>Google</td>
<td>Motorola Mobility</td>
<td>9,800,000,000</td>
</tr>
<tr>
<td>2011</td>
<td>Microsoft Corporation</td>
<td>Skype</td>
<td>8,500,000,000</td>
</tr>
<tr>
<td>2011</td>
<td>Berkshire Hathaway</td>
<td>Lubrizol</td>
<td>9,220,000,000</td>
</tr>
<tr>
<td>2012</td>
<td>Deutsche Telekom</td>
<td>MetroPCS</td>
<td>29,000,000,000</td>
</tr>
<tr>
<td>2013</td>
<td>Softbank</td>
<td>Sprint Corporation</td>
<td>21,600,000,000</td>
</tr>
<tr>
<td>2013</td>
<td>Berkshire Hathaway</td>
<td>H. J. Heinz Company</td>
<td>28,000,000,000</td>
</tr>
<tr>
<td>2013</td>
<td>Microsoft Corporation</td>
<td>Nokia Handset &amp; Services Business</td>
<td>7,200,000,000</td>
</tr>
<tr>
<td>2014</td>
<td>Face book</td>
<td>WhatsApp</td>
<td>19,000,000,000</td>
</tr>
<tr>
<td>2014</td>
<td>Comcast</td>
<td>Time Warner Cable</td>
<td>45,200,000,000</td>
</tr>
<tr>
<td>2014</td>
<td>SAP</td>
<td>Concur Technologies</td>
<td>8,300,000,000</td>
</tr>
<tr>
<td>2014</td>
<td>AT&amp;T</td>
<td>DirecTV</td>
<td>67,100,000,000</td>
</tr>
</tbody>
</table>

(Source: http://en.wikipedia.org/wiki/Mergers_and_acquisitions)

Table: 3.2 Other Notable M&A Deals from 2010 To 2014

### 3.11 Top 10 Acquisitions Made By Indian Companies Worldwide

<table>
<thead>
<tr>
<th>ACQUIRER</th>
<th>TARGET COMPANY</th>
<th>COUNTRY TARGETED</th>
<th>DEAL VALUE</th>
<th>INDUSTRY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tata Steel</td>
<td>Corus Group plc</td>
<td>UK</td>
<td>12,000</td>
<td>Steel</td>
</tr>
<tr>
<td>Hindalco</td>
<td>Novelis</td>
<td>Canada</td>
<td>5,982</td>
<td>Steel</td>
</tr>
<tr>
<td>Videocon</td>
<td>Daewoo Electronics Corp.</td>
<td>Korea</td>
<td>729</td>
<td>Electronics</td>
</tr>
<tr>
<td>Dr. Reddy’s Labs</td>
<td>Betapharm</td>
<td>Germany</td>
<td>597</td>
<td>Pharmaceutical</td>
</tr>
<tr>
<td>Suzlon Energy</td>
<td>Hansen Group</td>
<td>Belgium</td>
<td>565</td>
<td>Energy</td>
</tr>
<tr>
<td>HPCL</td>
<td>Kenya Petroleum Refinery Ltd.</td>
<td>Kenya</td>
<td>500</td>
<td>Oil and Gas</td>
</tr>
<tr>
<td>Ranbaxy Labs</td>
<td>Terapia SA</td>
<td>Romania</td>
<td>324</td>
<td>Pharmaceutical</td>
</tr>
<tr>
<td>Tata Steel</td>
<td>Natsteel</td>
<td>Singapore</td>
<td>293</td>
<td>Steel</td>
</tr>
<tr>
<td>Videocon</td>
<td>Thomson SA</td>
<td>France</td>
<td>290</td>
<td>Electronics</td>
</tr>
<tr>
<td>VSNL</td>
<td>Teleglobe</td>
<td>Canada</td>
<td>239</td>
<td>Telecom</td>
</tr>
</tbody>
</table>

Table: 3.3 Top 10 Acquisitions Made By Indian Companies Worldwide
If the above-mentioned table is analyzed, it is seen that out of total ten mergers and acquisitions, Tata Group contributes two major acquisitions to Indian economy.

3.12 Accounting for Amalgamation – As 14

The Institute of Chartered Accountants of India has formulated Accounting Standard (AS) 14 for accounting requirement of merger and amalgamation. This standard became effective from April 1, 1995.

This is a mandatory standard required to be followed by all the companies. This standard however does not deal with those cases where a company merely acquired the shares of the target company, either for cash or by the issue of the acquirer company’s shares or partly both. The reason for this is that in such an acquisition the target company continues to exist whereas AS 14 deals with those cases where the amalgamating companies cease to exist.\(^{20}\)

The accounting standard talks of two methods of amalgamation – amalgamation in the nature of merger and amalgamation in the nature of purchase.\(^{21}\)

3.12.1 Amalgamation in the Nature of Merger:

In order to qualify as an amalgamation by way of merger, the amalgamation has to satisfy each of the following five conditions:

a. All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company

b. Shareholders holding not less than 90 percent of the face value of the equity shares of the transferor company (other than the equity shares already held therein immediately before the amalgamation, by the transferee company or the subsidiaries or their nominees) become the equity shareholders of the transferee company by virtue of the amalgamation.

c. The transferee company discharges the consideration for amalgamation received by those equity shareholders of the transferor company who agree to become the shareholders of the transferee company wholly by the issue of

\(^{20}\)(Godbole, 2012)  
\(^{21}\)(Godbole, 2012)
equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

d. The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

e. No adjustment is intended to be made in the book value of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure the uniformity of accounting policies.

3.12.2 Amalgamation in the Nature of Purchase:

Accordingly, an amalgamation in which any one or more of the above conditions is not satisfied, the same is considered as amalgamation by way of purchase.

3.12.3 Methods of Accounting

1. **Pooling of interest method:** In case of an amalgamation by way of merger, the method of accounting is “Pooling of Interest method”

   Under this method following norms, are required to be adhered to:

   a. In preparing the transferee company’s financial statements, the assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of the transferor company should be recorded at their existing carrying amounts and in the same form as at the time of amalgamation.

   b. Even the reserves under various heads in the transferor company’s books have to be accounted under the same heads in the transferee company’s books. Thus ‘revaluation reserves’ of the transferor company will become or get added to the revaluation reserves of the transferee company.

   c. The difference between the amount recorded as the share capital issued and the amount of share capital of the transferor company should be adjusted in reserves.

2. **Purchase method:**

   Under the purchase method, following norms are required to be adhered to:

   1. With regard to assets and liabilities, the transferee company can

      a. Record the assets and liabilities of the transferor company at their existing carrying values,
b. Allocate the consideration to the individual identifiable assets and liabilities based on their fair values at the date of amalgamation.

2. With regard to the reserves of the transferor company, the transferee company should not include them in its books.

### 3.12.4 Ind-AS 103 Business Combinations

The globalization has created an increased need of conjunction of communication, culture, custom and businesses all over the world. It has endorsed Indian business leaders to do business off shore and encouraged multinationals to expand into India. As a result need of standardized way to convey the financial performance emerged. International Accounting Standard Board (IASB) has come out with the set of accounting standards applicable globally being capable to be incorporated by developed, emerging and developing economies. These standards are known as International Financial Reporting Standards (IFRS).

The Council of Institute of Chartered Accountants of India formulates Indian Accounting Standards (ASs). In the year 2007, it was decided to adopt International Financial Reporting Standards by all listed, public interest and large sized entities from accounting period beginning from 1st April, 2011. Ministry of Corporate Affairs decisiveness for not adopting IFRS but converging IFRS, Ind-AS came into existence. Adoption of IFRS means incorporating IFRS as stated by IASB and convergence means Indian Accounting Standard Board and International Accounting Standard Board together to develop high quality compatible accounting standards. On 25th April, 2011, Ministry of Corporate Affairs notified 35 Accounting Standards which are known as Ind-AS. Indian has converged IFRS into Indian IFRS (Ind-AS).

The application of Ind AS is based on the listing status and net worth of a company. Ind AS will first apply to companies with a net worth equal to or exceeding 500 crore INR beginning 1 April 2016. This will also require comparative Ind AS information for the period of 1 April 2015 to 31 March 2016. Listed companies as well as others having a net worth equal to or exceeding 250 crore INR will follow 1 April 2017 onwards. From April 2015 (which is less than six weeks away) companies impacted in the first phase will have to take a closer look at the details of the 39 new
Ind ASs currently notified. Ind AS will also apply to subsidiaries, joint ventures, associates as well as holding companies of the entities covered by the roadmap.\(^{22}\)

We cannot deny the fact that the Indian companies are expanding their business operations worldwide finding the best-fit combination. AS 14 laid down the accounting treatment in case of amalgamation that is not in line with global standards. Hence ICAI has converged AS 14 to Ind-AS 103 to standardize the accounting treatments which is in line with IFRS 3. With the cross border mergers and acquisitions, compatibility of Indian Accounting Standard with International Financial Reporting Standards is challenging but very much necessary for reflecting true and fair view of corporate affairs.

The objective of this Indian Accounting Standard (Ind AS) is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. To accomplish that, thousand AS establishes principles and requirements for how the acquirer:

(a) Recognize and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the Acquiree;
(b) Recognizes and measures the goodwill acquired in the business combination or again from a bargain purchase\(^1\); and
(c) Determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

3.12.5 **Scope:** Ind AS 103 defines business combination that has a wider scope. A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses. It includes both amalgamation and acquisition including common control transactions. Common Control transactions means, if there are three companies A Ltd., B Ltd. and C Ltd. Both A Ltd and B Ltd are under C Ltd it is known as common control transactions.

3.12.6 **Reverse Acquisition:** Ind-AS deals with the reverse acquisitions. Reverse acquisition takes place when a private entity wants to become a public entity but does not want to register its equity shares. In such case, private entity approaches a public

\(^{22}\) (PWC, 2015)
entity, i.e. the one which is listed, to acquire its (private entity’s) equity interests in exchange for the equity interests of the public entity to acquire its (private entity’s) equity interests in exchange for the equity interests of the public entity.\textsuperscript{23} Ind-AS also excludes formation of Joint Venture and acquisition of a group of assets or assets not constituting the business combinations of entities.

### 3.12.7 Method of Accounting:
Under Ind-AS 103 only acquisition method is used for business combinations. Moreover, it is mandatory to adopt purchase method in accounting for business combinations.

### 3.12.8 Steps in Acquisition Methods:\textsuperscript{24}
1. Identifying the acquirer
2. Determining the acquisition date
3. Recognizing and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the Acquiree
4. Recognizing and measuring goodwill or a gain from bargain purchase

Convergence has depicted the following difference between AS 14 Accounting for Amalgamation and Ind-AS 103 Business Combinations

<table>
<thead>
<tr>
<th>Particulars</th>
<th>AS 14</th>
<th>Ind-AS 103</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scope</strong></td>
<td>Confined only to Amalgamation</td>
<td>wider scope and includes common control transactions</td>
</tr>
<tr>
<td><strong>Method of Accounting</strong></td>
<td>Two methods of Accounting: 1. Pooling of interest method 2. Purchase method</td>
<td>Only acquisition method</td>
</tr>
<tr>
<td><strong>Valuation of Assets and Liabilities</strong></td>
<td>Carrying value in case of pooling of interest method and in purchase method either carrying value or fair value</td>
<td>To be recognized at fair value method</td>
</tr>
<tr>
<td><strong>Goodwill</strong></td>
<td>Goodwill = Purchase consideration - Net Assets</td>
<td>Goodwill = Aggregate consideration + Non-controlling interest + previously held equity interest - Net identifiable assets and liabilities</td>
</tr>
</tbody>
</table>

\textsuperscript{23}(Tripathi, 2014)
\textsuperscript{24}(Tripathi, Converged Ind AS 103 Business Combination and Treatment of Goodwill and Bargain Purchase, 2014)
<table>
<thead>
<tr>
<th>Valuation of Goodwill</th>
<th>Amortized over a period of five years (in the nature of purchase) and adjusted against Revenue Reserve (in the nature of merger)</th>
<th>Goodwill is not amortized</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gain on bargain purchase</td>
<td>Excess of net assets over purchase consideration = Capital Reserve</td>
<td>Gain recognized as other comprehensive income and accumulated in equity as Capital Reserve</td>
</tr>
<tr>
<td>Reverse transaction</td>
<td>Does not deals with Reverse Acquisition</td>
<td>Deals with Reverse Acquisition</td>
</tr>
</tbody>
</table>

Extended business transactions all over the world and materialism in strategic business expansions have compelled corporate to indulge uniformity in communicating financial performance to the varied stakeholders at different corners of the world. Convergence of AS-14 Accounting for Amalgamations to Ind-AS 103 Business Combinations will assist to reach compatibility of Indian Accounting standards with International Accounting Standards.

3.12.9 Taxation Aspects of Amalgamation:

In order to qualify as amalgamation within the meaning of the Income Tax Act, 1961, following three conditions need to be satisfied. [Section 2(1B)]

- All the properties of the amalgamating company, immediately before an amalgamation, should become properties of the amalgamated company by virtue of amalgamation.
- All the liabilities of the amalgamating company, immediately before an amalgamation, should become liabilities of the amalgamated company by virtue of amalgamation.
- Shareholders holding not less than three fourth (in value) of the shares in the amalgamating company should become shareholders of the amalgamated company by virtue of amalgamation.
3.12.10 Implications In Terms of Capital Gains Tax

In respect of those amalgamations and demergers, which conform to their respective definitions above, following transactions are not treated as transfer of a capital asset and therefore no capital gains tax is chargeable.

a. Transfer of a capital asset in the scheme of amalgamation, if the amalgamated company is an Indian company. Section 47(vi)

b. Transfer of a capital asset in the scheme of demerger, if the resulting company is an Indian company. [Section 47(vi b)]

c. Allotment of shares in an amalgamated company in lieu of shares of an amalgamating company if

   The transfer is in consideration of the shares of the amalgamated company
   The amalgamated company is an Indian company [Section 47(vii)]

d. Any issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company [ Section 47(vi d)]

e. Transfer of shares in an Indian company held by a foreign company to another foreign company under the scheme of amalgamation of two foreign companies [section 47(vi a)] provided:

   i) At least 25 per cent of the shareholders of the amalgamating foreign company continue to be the shareholders of the amalgamated foreign company
   ii) Such transfer attracts no capital gain tax in the country in which the amalgamating company is incorporated.

f. Transfer of shares held in an Indian company by demerged foreign company to the resulting foreign company [Section 47(vi c)]

   i) At least 75 per cent of the shareholders of the demerged foreign company continue to be the shareholders of the resulting foreign company
   ii) Such transfer attracts no capital gains tax in the country in which the demerged company is incorporated.

The following transactions relating to some other forms of capital structuring are not treated as transfer of capital assets, and therefore no capital gains tax is chargeable:

a) Transfer of capital asset by a company to its 100 per cent subsidiary [ section 47(iv)]
b) Transfer of capital asset by 100 per cent subsidiary company to its parent company [section 47(v)]

In both the above cases of transfer between the per cent and the 100 per cent subsidiary company, the transferee company must be an Indian company.

Further, such transactions will be chargeable to tax if:

i) The transferee company takes over the capital asset into stock in trade at the time of transfer or

ii) The transferee company converts the capital asset into stock in trade within a period of eight years or

iii) The holding company ceases to hold the entire share capital of the subsidiary company within a period of eight years.

In such a case, the capital gains will be taxed in the hands of the transferor company and the cost in the hands of the transferee company will be the actual cost at which it acquired the asset.
3.13 Legal and Regulatory Framework of M&A

3.13.1 Indian Companies Act, 1956:

Section 390 to 396 of Companies Act 1956 relates to mergers and acquisitions. The act lays down the following procedures:25

(1) Permission for merger: amalgamation is possible between two or more companies only when the amalgamation is permitted under their memorandum of association and the acquiring company has the permission in its object clause to carry on the business of the acquired company. It is necessary to seek the permission of board of directors, the shareholders and the Company Law Board effecting the merger in the absence of permission by the memorandum of association.

(2) Information to the stock exchange: the acquiring and the acquired companies should inform the stock exchanges where they are listed about the merger.

(3) Approval of board of directors: the board of directors of the individual companies should approve the draft proposal for amalgamation. The board of directors should also authorize the managements of the companies to further pursue the proposal.

(4) Application in the high court: For approval of the draft amalgamation proposal duly approved by the board of directors of the individual companies, an application should be presented to the High Court.

(5) Shareholders and creditors’ meeting: the individual companies for approving the amalgamation scheme should hold separate meetings of shareholders and creditors. The scheme should be approved by voting in person or by proxy by at least 75 percent of shareholders and creditors in separate meetings.

(6) Sanction by the high court: the High court will pass an order, sanctioning the amalgamation scheme once it is satisfied, after the approval of the shareholders and creditors of the petition of the companies.

(7) Filing of the court order: Certified true copies of the court order will be filed with the Registrar of Companies

25(Mr.R.Vadapalli, 2010)
(8) Transfer of assets and liabilities: The acquired company assets and liabilities will be transferred to the acquiring company in accordance with the agreed scheme, with effect from the specified date.

(9) Payment by cash or securities: As per the proposal, the acquiring company will exchange shares and debentures and/or cash for the shares and debentures of the acquired company. These securities will be listed on the stock exchange.

3.13.2 Foreign Exchange Management Act, 1999

The provision of Foreign Exchange Management Act, 1999 are applicable to cross border mergers and acquisitions. It aims at regulating cross border mergers and acquisitions as the deal may involve use of foreign exchange for settling of the transactions.

The law contains provisions relating to issuance and allotment of shares to foreign entities. The Foreign Exchange Management (transfer or issue of security by a person residing outside India) Regulation, 2000 issued by the Reserve Bank of India (RBI) vide notification no. FEMA 20/2000-RB dated 3 May 2000 contains general provisions for inbound and outbound cross border M&As in India.

The provisions state that once the scheme of merger or amalgamation of two or more Indian companies has been approved by a court in India, the transferee company or new company can issue shares to the shareholders of the transferor company resident outside India subject to the following condition.

The percentage of shareholding of person resident outside India in the transferee or new company does not exceed the prescribed sectoral cap.

The transferor company or the transferee / new company is not engaged in activities that are prohibited under the FDI policy.
3.13.3 The Competition Act, 2002

The Competition Act, 2002 deals with anti-competitive agreements and provides that any agreement entered into by business entities engaged in identical or similar trade of goods or provision of services, regarding any aspect/s of business which has the effect of causing an appreciable adverse effect on competition within India is regarded as anti-competitive agreement and is consequently considered void.

A combination, which causes or is likely to cause an appreciable adverse effect on competition in the relevant market in India, is prohibited. The Competition Commission of India must be notified of the proposal of entering into such a combination and failure to do so may lead to the imposition of a fine that may extend to one per cent of the total turnover or the assets of the combination, whichever is higher. The directors of the entity involved in the combination must make this notification within 30 days of the approval of the combination. However, the Commission may take up to 210 days to adjudicate upon whether the proposed combination would have an adverse effect on competition in the relevant market. During this 210-day period, the Commission is further required to formulate its initial opinion within 30 days of receipt of the notification. In the event that the Commission does not pass an order within the given 210 day timeframe, it would be deemed that the proposed combination would not have an adverse effect on competition in the relevant market.

In order to determine whether a combination has or likely to have appreciable adverse effect on competition in the relevant market the Commission would analyze all or any of the following factors, namely:

(a) Actual and potential level of competition through imports in the market
(b) Extent of barriers to entry in the market
(c) Level of combination in the market
(d) Degree of countervailing power in the market
(e) Likelihood that the combination would result in the parties to the combination being able to significantly and sustainable increase prices or profit margins

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26(Ransaria)
27(Majumdar, 2013)
(f) Extent of effective competition likely to sustain in a market
(g) Extent to which substitutes are available or are likely to be available in the market
(h) Market share, in the relevant market, of the person or enterprise in a combination,
   Individually and as a combination
(i) Likelihood that the combination would result in the removal of a vigorous and
   Effective competitor or competitors in the market
(j) Nature and extent of vertical integration in the market
(k) Possibility of a failing business
(l) Nature and extent of innovation
(m) Relative advantage, by way of the contribution to the economic development, by
   anyCombination having or likely to have appreciable adverse effect on
   competition
(n) Whether the benefits of the combinations outweigh the adverse impact of the
   Combinations if any

3.13.4 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.

3.13.5 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.

3.13.6 Legal Procedure - Merger of Companies

(1) **Examination of object clauses:** The MOA of both the companies should be examined to check the power to amalgamate is available. Further, the object clause of the merging company should permit it to carry on the business of the merged company. If such clauses do not exist, necessary approvals of the shareholders, board of directors, and company law board are required.

(2) **Intimation to stock exchanges:** The stock exchanges where merging and merged companies are listed should be informed about the merger proposal. From time to time, copies of all notices, resolutions, and orders should be mailed to the concerned stock exchanges.

(3) **Approval of the draft merger proposal by the respective boards:** The respective BOD’s should approve the draft merger proposal. The board of each company should pass a resolution authorizing its directors/executives to pursue the matter further.

(4) **Application to high courts:** Once the drafts of merger proposal is approved by the respective boards, each company should make an application to the high court of the state where its registered office is situated so that it can convene the meetings of shareholders and creditors for passing the merger proposal.

(5) **Dispatch of notice to shareholders and creditors:** In order to convene the meetings of shareholders and creditors, each company to its shareholders and creditors should dispatch a notice and an explanatory statement of the meeting, as approved by the high court, so that they get 21 days advance intimation. The notice of the meetings should also be published in two newspapers.

(6) **Holding of meetings of shareholders and creditors:** A meeting of shareholders should be held by each company for passing the scheme of
mergers at least 75% of shareholders who vote either in person or by proxy must approve the scheme of merger. It applies to creditors also.

(7) **Petition to High Court for confirmation and passing of HC orders:** Once the shareholders and creditors pass the mergers scheme, the companies involved in the merger should present a petition to the HC for confirming the scheme of merger. A notice about the same has to be published in 2 newspapers.

(8) **Filing the order with the registrar:** Certified true copies of the high court order must be filed with the registrar of companies within the time limit specified by the court.

(9) **Transfer of assets and liabilities:** After the final orders have been passed by both the HC’s, all the assets and liabilities of the merged company will have to be transferred to the merging company.

(10) **Issue of shares and debentures:** The merging company, after fulfilling the provisions of the law, should issue shares and debentures of the merging company. The new shares and debentures so issued will then be listed on the stock exchange.
Bibliography:


**Webliography:**

