2.1 Introduction to Corporate Restructuring:

A change in the existing environment of business, calls for a change in the way in which companies within that business environment operate. If the change in environment is drastic, then the change in companies would also have to be as dramatic, sometimes even more so. When this dramatic change is to do with changing the entire structure of the company, it is known as Corporate Restructuring. Any type of restructuring is aimed at either growth or achieving sustainability.

An entrepreneur may grow his business either by internal expansion or by external expansion. In the case of internal expansion, a firm grows gradually over time in the normal course of the business, through acquisition of new assets, replacement of the technologically obsolete equipments and the establishment of new lines of products. But in external expansion, a firm acquires a running business and grows overnight through corporate combinations. These combinations are in the form of mergers, acquisitions, amalgamations and takeovers and have now become important features of corporate restructuring. They have been playing an important role in the external growth of a number of leading companies the world over. They have become popular because of the enhanced competition, breaking of trade barriers, free flow of capital across countries and globalisation of businesses. In the wake of economic reforms, Indian industries have also started restructuring their operations around their core business activities through acquisition and takeovers because of their increasing exposure to competition both domestically and internationally.

Mergers and acquisitions are strategic decisions taken for maximisation of a company's growth by enhancing its production and marketing operations. They are being used in a wide array of fields such as information technology, telecommunications, and business process outsourcing as well as in traditional businesses in order to gain strength, expand the customer base, cut competition or enter into a new market or product segment.
2.1.1 The need for restructuring:
- Companies may take up some sort of restructuring process in order to **enter new product markets.**
- In **order to expand capacities,** new investment may be made and that would lead to restructuring.
- Corporate restructuring is often taken up in order to **increase the efficiency of the firms.** Efficiency may refer to management efficiency or financial efficiency.
- Restructuring activities such as mergers, acquisitions, sell offs, spin offs etc. may be taken up in order to increase **economies of scale.**
- Corporate restructuring may lead to less wastage and **optimum utilization of resources.**
- Restructuring activities such as mergers, acquisitions and Leveraged buy outs in related industries are carried out in order to beat or **reduce competition.**
- Many a times, **industrial sickness** may also culminate into restructuring activities.

2.1.2 Types of Restructuring:

2.1.2.1 Expansion:

Whenever a restructuring activity involves increasing a firm’s capacity, market share, product breadth or any such activity which would lead to an increase in size of the existing firm, then such a restructuring activity would be termed as expansion.

(a) **Mergers & Acquisitions:**

Mergers/Acquisitions\(^1\): Any transaction that forms one economic unit from two or more previous ones is known as a merger.

Mergers are of three forms: Horizontal, Vertical and Conglomerate.

\(^1\) In many theoretical expositions, the terms mergers and acquisitions have been used interchangeably.
(b) Tender Offers:

In a tender offer, one party, generally, a corporation seeking a controlling interest in another corporation asks the stockholders of the firm it is seeking to control to submit or tender their shares of stock in the firm.

Gaining control is the gist in this type of restructuring.

If one firm wants to gain control over another there are three ways to do it:

- It typically seeks approval for the merger from the other firm’s management and Board of Directors.
- **Bear hug**: in this approach, a company mails a letter to the BOD to make a quick decision on the bid. Example: Arcelor – Mittal
- Third alternative is to approach the shareholders of the target company directly and buying shares from them. If approval cannot be obtained from the BOD, the acquiring company can appeal directly to the stockholders by means of the tender offer. This type of forceful acquisition is also known as a hostile takeover.

  If shareholders respond favourably, the acquiring company will gain control and have the power to replace the directors who have not cooperated in the takeover effort.

**White knight:**

The target firm may seek to join with another firm with which it would rather partner it considers more desirable – a **white knight**.

(c) Joint ventures:

Joint ventures involve the intersection of only a small fraction of the activities of the companies involved and usually for a limited duration of ten to fifteen years or less. Examples: Maruti-Suzuki, Hero-Honda, Mahindra-Nissan.
2.1.2.2 **Sell Offs:**

Sell offs are the opposites of Mergers or Acquisition. There are two sides of every deal - The side of the buyer and the side of the seller. There are different types of sell offs:

(a) **Spin offs:**

A spin off creates a new separate legal entity. Its shares are distributed on a pro rata basis to existing shareholders of the parent company. Thus, existing shareholders have the same proportion of ownership in the entity as in the original firm. Ex: GE spun off into Great offshore and GE. There is a separation of control. The new entity as a separate decision making unit may develop policies and strategies different from those of the original parent. In effect a spin off represents a form of dividend to the existing shareholders.

i. Split offs:

In a split off, the shareholders of the existing company get shares in subsidiary company in exchange of parent company stock.

ii. Split ups:

The entire firm is broken up in a series of spin offs, so that parent no longer exists and only the new offspring survive.

(b) **Divestitures:**

A divestiture involves the sale of a portion of the firm to an outside third party. Cash or equivalent consideration is received by the divested firm. Usually the buyer is an existing firm. So, no new legal entity results. It simply results in a form of expansion on the part of the buying firm. Example: Sale of IPCL to Reliance; Disinvestments of PSUs by GOI.

iii. Equity carve outs:

Equity carve out results when an existing firm sells out a portion of the company via an equity offering to outsiders. New equity shares are sold to outsiders, which give them ownership of a portion of the previously existing firm. A new legal entity is created.
2.1.2.3 Corporate Control:

(a) Premium Buybacks:
A premium buyback happens when the company repurchases a substantial stock holder’s ownership interest at a premium above the market price. Example: DSP-Meryll Lynch: Meryll Lynch bought over Hemendra Kothari’s share from the above company. It is also called green mail.

(b) Standstill Agreements:
Often, in connection to premium buybacks, standstill agreements are written. A Standstill Agreement represents a voluntary contract in which the stock holder who is bought over agrees not to make further attempts to take over the company in future. When a standstill agreement is made without a buyback, the substantial stock holder simply agrees not to increase his or her ownership which presumably would put him in a controlling position.

(c) Anti-takeover Amendments:
These are changes in the corporate by-laws to make an acquisition of the company more difficult or more expensive.

These include:
- Supermajority voting provisions requiring a high percentage of stock holders to approve a merger.
- Staggered terms for directors which can delay change of control for a number of years.
- Golden parachutes which award large termination payments to existing management if control of the firm is changed and management is terminated.

(d) Proxy Contests:
In a proxy contest, an outside group seeks to obtain representation on the firm’s Board of Directors. The outsiders are referred to as “dissidents” or “insurgents”. They seek to reduce the control of the “incumbents” or existing Board of Directors.
2.1.2.4 Changes In Ownership Structure:

(a) Exchange Offers:
Exchange offers involve exchange of debt or preferred stock for common stock or vice versa. Exchanging debt for common stock increases leverage; exchanging common stock for debt decreases leverage.

(b) Share Repurchases:
In a share repurchase a corporation buys back some fraction of its outstanding shares of common stock. Tender offers may be made for share repurchase.

(c) Going Private:
In this type of transaction, the entire equity interest in a previously public corporation is purchased by a small group of investors. The firm is no longer subject to the regulations of the SEBI, whose purpose is to protect public investors. When such a transaction is initiated by the incumbent management itself, it is called Management Buy-out. Example of management Buy-out: UB group chairman Mr. Vijay Mallya exited from the sorghum beer business in South Africa. The group company UB Holdings offloaded United National Breweries (UNB), the sorghum beer company, to a management buyout led by its chief executive officer and managing director Rajan Ranganathan. The deal size was roughly $16 million.

(d) Leveraged Buy-outs:
Whenever a buyer company borrows funds from third party investors in the form of debt, in order to buy out another company, then such a transaction becomes a leveraged buy-out.

2.2 Definitive aspects:

2.2.1 Mergers or Amalgamations:
A merger is a combination of two or more businesses into one business. Laws in India use the term 'amalgamation' for merger. The Income Tax Act, 1961 [Section 2(1A)] defines 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 assets and liabilities of the amalgamated company and shareholders not less than nine-tenths in value of the shares in the amalgamating company or companies become shareholders of the amalgamated company.

Thus, mergers or amalgamations may take two forms:

(a) **Merger through Absorption:**
An absorption is a combination of two or more companies into an 'existing company'. All companies except one lose their identity in such a merger. For example, absorption of Tata Fertilisers Ltd (TFL) by Tata Chemicals Ltd. (TCL). TCL, an acquiring company (a buyer), survived after merger while TFL, an acquired company (a seller), ceased to exist. TFL transferred its assets, liabilities and shares to TCL.

(b) **Merger through Consolidation:**
A consolidation is a combination of two or more companies into a 'new company'. In this form of merger, all companies are legally dissolved and a new entity is created. Here, the acquired company transfers its assets, liabilities and shares to the acquiring company for cash or exchange of shares. For example, merger of Hindustan Computers Ltd, Hindustan Instruments Ltd, Indian Software Company Ltd and Indian Reprographics Ltd into an entirely new company called HCL Ltd.

A fundamental characteristic of merger (either through absorption or consolidation) is that the acquiring company (existing or new) takes over the ownership of other companies and combines their operations with its own operations.

Besides, there are three major types of mergers:

(i) **Horizontal merger:**
A horizontal merger is a combination of two or more firms in the same area of business. For example, combining of two book publishers or two luggage manufacturing companies to gain dominant market share.
(ii) **Vertical merger:**

It is a combination of two or more firms involved in different stages of production or distribution of the same product. For example, joining of a TV manufacturing (assembling) company and a TV marketing company or joining of a spinning company and a weaving company. Vertical merger may take the form of forward or backward merger. When a company combines with the supplier of material, it is called backward merger and when it combines with the customer, it is known as forward merger.

(iii) **Conglomerate merger:**

It is a combination of firms engaged in unrelated lines of business activity. For example, merging of different businesses like manufacturing of cement products, fertilizer products, electronic products, insurance investment and advertising agencies. L&T and Voltas Ltd. are examples of such mergers. Conglomerate Mergers can be of three types:

- **Product extension:** Broadens the product line of the firm.
- **Market extension:** Broadens the market of the firm.
- **Pure conglomerate:** Merging companies have no relation with each other’s business.

### 2.2.2 Acquisitions and Takeovers:

An acquisition may be defined as an act of acquiring effective control by one company over assets or management of another company without any combination of companies. Thus, in an acquisition two or more companies may remain independent, separate legal entities, but there may be a change in control of the companies. When an acquisition is 'forced' or 'unwilling', it is called a takeover. In an unwilling acquisition, the management of 'target' company would oppose a move of being taken over. But, when managements of acquiring and target companies mutually and willingly agree for the takeover, it is called acquisition or friendly takeover.

Under the Monopolies and Restrictive Practices Act, takeover meant acquisition of not less than 25 per cent of the voting power in a company. While in the Companies Act (Section 372), a company's investment in the shares of another company in excess of 10 per cent of the subscribed capital
can result in takeovers. An acquisition or takeover does not necessarily entail full legal control. A company can also have effective control over another company by holding a minority ownership.

2.3 Theories of Mergers:

2.3.1 Efficiency theories:

The efficiency theories hold that mergers and other forms of asset redeployment have potential social benefits. They involve improving the performance of incumbent management. Most of the efficiency theories are used for conglomerate mergers.

*(a) Differential managerial efficiency:*

This theory states that if management of firm A is better than management of firm B, and firm A takes over firm B, then the management of B will rise up to the level of A. Social as well as private gain would arise from such a scenario. The problem is that if all firms take up this route, then there will be only one firm in the economy.

*It will benefit:*

(i) If firm A (acquiring firm) has excess managerial capacity and firm B (acquired firm) has non managerial organizational capital.

(ii) Firms with below average efficiency.

(iii) Firms operating in similar kinds of business activities which are weak in management.

*(b) Inefficient management:*

This theory is similar to differential efficiency. However, horizontal mergers are more relevant in differential management whereas, even conglomerate mergers are relevant in inefficient management.

*(c) Operating synergy:*

Operating synergy may be achieved in horizontal, vertical and even in conglomerate mergers. The theory based on operating synergy assumes that economies of scale do exist in the industry and that
prior to the merger; the firms are operating at levels of activity that fall short of achieving the potentials for economies of scale. Economies of scale arise because of invisibilities, such as people, equipment and overhead, which provide increasing returns if spread over a large number of units of output. This theory says that operating synergies in terms of manufacturing facilities, plant, research and development, management functions etc. originate due to mergers and hence gains result from merger activity.

(d) **Pure diversification:**

Diversification gives an opportunity to employees to improvise their skill and learn new skills and helps the businessman to reduce his risk. When a firm is liquidated, all firm related information is lost. If a firm is diversified then this firm specific information can be transferred to the new firm. Reputational capital of firm can also be used. Diversification can increase the corporate debt capacity of the firm and decrease the present value of future tax liability.

(e) **Financial synergy:**

Another school of thought says that only operating synergy is not enough. Hence comes in the concept of financial synergy. Synergy, with respect to raising funds, internal and external capital, working capital (vertical mergers), etc. is achieved due to mergers. This is known as financial synergy and this type of synergy leads to merger gains.

(f) **Strategic realignment to changing environments:**

Strategic planning is concerned with the firm’s environments and constituencies, not just operating decisions. The strategic planning approach to mergers implies either the possibilities of economies of scale or tapping underused capacity in the firm’s present managerial capabilities. The speed of adjustment to the change in the environment through merger would be quicker than internal development. Developing the required skills and managerial capabilities internally would be time consuming and difficult. Mergers provide an easy route to overcome these.
(g) **Undervaluation:**

If a certain firm is undervalued, it is quite likely that another firm would want to acquire it.

Reasons for undervaluation:
(i) Underutilization of assets by management.
(ii) Acquirers have inside information.
(iii) Difference between market value of assets and replacement costs.

2.3.2 **Information and Signaling:**

(a) **Information theory:**

It has been observed frequently that the value of shares of the target firm increases even if the tender offer goes unsuccessful.

*The reasons:*

(i) The tender offer disseminates information that the target shares are undervalued. It is also known as *sitting on the goldmine.*
(ii) The offer compels the target firm to perform well on its own.
(iii) Another view is that people expect that the company will be taken over by someone else.

(b) **Signaling theory:**

Certain actions of the firm give signals to the market due to which the firm benefits. For example, investors use the face amount of debt that the manager decides to issue as a signal of the firm’s probable performance. If the optimum amount of debt to be held by a company is D. Say there are 2 types of firms A and B. A will be successful, B will be unsuccessful. If the firm issues debt more than D, then is termed as type A, if less than D, then type B. Firm B should signal its unsuccessfulness only if the benefit from telling the truth is greater than that produced by telling lies.

Signaling may be involved in mergers in a number of ways. The fact that a firm has received a tender offer may signal to the market that hitherto unrecognized extra values are possessed by the firm or that future cash flow streams are likely to rise. When a bidder firm uses common stock in buying another firm, this may be taken as a
signal by the target and others that the common stock of the bidder firm is overvalued. When business firms repurchase their shares, the market may take this as a signal that management has information that its shares are undervalued and that favourable new growth opportunities will be achieved.

2.3.3 Agency Problems and Managerialism:

(a) An agency problem arises when managers own only a small portion of the ownership shares of the firm. This partial ownership may cause managers to work less vigorously than otherwise and to consume more perquisites because majority owners bear most of the cost. Agency problems arise because:

Contracts between managers (decision or control agents) and owners cannot be costlessly written and enforced.

Agency costs include:

(i) Cost of structuring contracts.
(ii) Costs of monitoring and controlling the behaviour of agents.
(iii) Costs of taking guarantee that agents will make optimal decision.
(iv) Residual loss to principals (majority shareholders).
(v) Takeovers are a solution to agency problems.

(b) Managerialism:

This theory argues that the agency problem is not solved and the merger activity is a manifestation of the agency problems of inefficient external investments by managers.

2.3.4 Hubris Hypothesis:

Managers commit errors of over optimism in evaluating merger opportunities due to excessive pride, animal spirits or Hubris. So the whole merger movement is based on taking the hubris hypothesis as the null hypothesis and disproving it.

2.3.5 Free Cash Flow Hypothesis:

Major conflicts between managers and shareholders arise over the payment of free cash flows. Free cash flows are basically profits after all the expenses are deducted. Distribution of these profits becomes the main point of
contention. Agency costs result from these conflicts of interest that can never be resolved perfectly. Takeovers can help reduce these costs.

2.3.6 Market Power:

Concentration of power with a few firms through merger activities and collusions leads to better gains.

2.3.7 Tax Benefits:

Mergers can help in reducing the tax effect. If one firm is a loss making one, then the losses of this firm can be carried over to the profits of the other firm. This will reduce the overall profit and hence reduce the tax. Assets would be valued at a stepped up basis and hence there would be an added depreciation benefit. Ordinary gains can be substituted for capital gains and tax liabilities can be reduced.

2.4 Advantages of Mergers & Acquisitions

The most common motives and advantages of mergers and acquisitions are:

2.4.1 Growth:

Accelerating a company's growth, particularly when its internal growth is constrained due to paucity of resources is one of the main advantages of Mergers or Acquisitions. Internal growth requires that a company should develop its operating facilities- manufacturing, research, marketing, etc. But, lack or inadequacy of resources and time needed for internal development may constrain a company's pace of growth. Hence, a company can acquire production facilities as well as other resources from outside through mergers and acquisitions. Specially, for entering in new products/markets, the company may lack technical skills and may require special marketing skills and a wide distribution network to access different segments of markets. The company can acquire existing company or companies with requisite infrastructure and skills and grow quickly.

2.4.2 Increasing Profitability:

Profitability can be enhanced because a combination of two or more companies may result in more than average profitability due to cost reduction and efficient utilization of resources. This may happen because of:
(a) Economies of scale:
Economies of scale arise when increase in the volume of production leads to a reduction in the cost of production per unit. This is because, with merger, fixed costs are distributed over a large volume of production causing the unit cost of production to decline. Economies of scale may also arise from other indivisibilities such as production facilities, management functions and management resources and systems. This is because a given function, facility or resource is utilized for a large scale of operations by the combined firm.

(b) Operating economies:
Operating economies arise because a combination of two or more firms may result in cost reduction due to operating economies. In other words, a combined firm may avoid or reduce over-lapping functions and consolidate its management functions such as manufacturing, marketing, R&D and thus reduce operating costs. For example, a combined firm may eliminate duplicate channels of distribution, or create a centralized training center, or introduce an integrated planning and control system.

(c) Synergy:
Synergy implies a situation where the combined firm is more valuable than the sum of the individual combining firms. It refers to benefits other than those related to economies of scale. Operating economies are one form of synergy benefits. But apart from operating economies, synergy may also arise from enhanced managerial capabilities, creativity, innovativeness, R&D and market coverage capacity due to the complementarity of resources and skills and a widened horizon of opportunities.

2.4.3 Diversification:
Diversifying the risks of the company, particularly when it acquires those businesses whose income streams are not correlated, leads to reduction of risk. Diversification implies growth through the combination of firms in unrelated businesses. It results in reduction of total risks through substantial reduction of cyclicality of operations. The combination of management and
other systems strengthen the capacity of the combined firm to withstand the severity of the unforeseen economic factors which could otherwise endanger the survival of the individual companies.

2.4.4 **Financial Synergy:**

A merger may result in financial synergy and benefit for the firm in many ways:

- By eliminating financial constraints, as the resources of two or more firms would be merged.
- By enhancing debt capacity: This is because a merger of two companies can bring stability of cash flows which in turn reduces the risk of insolvency and enhances the capacity of the new entity to service a larger amount of debt.
- By lowering the financial costs: This is because due to financial stability, the merged firm is able to borrow at a lower rate of interest.

2.4.5 **Effectively facing Competition:**

The severity of competition can be reduced by increasing the company's market power. A merger can increase the market share of the merged firm. This improves the profitability of the firm due to economies of scale. The bargaining power of the firm vis-à-vis labour, suppliers and buyers, is also enhanced. The merged firm can exploit technological breakthroughs against obsolescence and price wars.

2.5 **Procedure for evaluating the decision for mergers and acquisitions:**

The three important steps involved in the analysis of M&As are:

1) **Planning:**

Planning for acquisition requires the analysis of industry-specific and firm-specific information. The acquiring firm should review its objective of acquisition in the context of its strengths and weaknesses and corporate goals. It will need industry data on market growth, nature of competition, ease of entry, capital and labour intensity, degree of regulation, etc. This will help in indicating the product-market strategies that are appropriate for the company. It will also help the firm in identifying the business units that should be dropped or added. On the other hand, the target firm will need information
about quality of management, market share and size, capital structure, profitability, production and marketing capabilities, etc.

2) **Search and Screening:**

Search focuses on how and where to look for suitable candidates for acquisition. Screening process short-lists a few candidates from the many available ones, and obtains detailed information about each of them.

3) **Financial Evaluation:**

Financial evaluation of a merger is needed to determine the earnings and cash flows, areas of risk, the maximum price payable to the target company and the best way to finance the merger. In a competitive market situation, the current market value is the correct and fair value of the share of the target firm. The target firm will not accept any offer below the current market value of its share. The target firm may, in fact, expect the offer price to be more than the current market value of its share since it may expect that merger benefits will accrue to the acquiring firm. A merger is said to be at a premium when the offer price is higher than the target firm's pre-merger market value. The acquiring firm may have to pay premium as an incentive to target firm's shareholders to induce them to sell their shares so that it (acquiring firm) is able to obtain the control of the target firm.
Figure No. 2.1 – The Basic Process of Mergers and Acquisitions:

1. Strategize
   - Select Targets
   - Screen
   - Approach
   - Conduct DD

2. Execute
   - Go
   - Engage
   - Negotiate/Structure
   - Go

3. Realize
   - Seek Approvals
   - Go

Source: (Boeh & Beamish, 2008)

Note: 1. DD = Due Diligence
       2. PMI = Post Merger
2.6. Regulations for Mergers & Acquisitions:

Mergers and acquisitions are regulated under various laws in India. The objective of the laws is to make these deals transparent and protect the interest of all shareholders. They are regulated through the provisions of:

2.6.1 The Companies Act, 1956:

The Act lays down the legal procedures for mergers or acquisitions:

(a) Permission for merger:

Two or more companies can amalgamate only when the amalgamation is permitted under their memorandum of association. Also, the acquiring company should have the permission in its object clause to carry on the business of the acquired company. In the absence of these provisions in the memorandum of association, it is necessary to seek the permission of the shareholders, board of directors and the Company Law Board before affecting the merger.

(b) Information to the stock exchange:

The acquiring and the acquired companies should inform the stock exchanges (where they are listed) about the merger.

(c) Approval of board of directors:

The board of directors of the individual companies should approve the draft proposal for amalgamation and authorise the managements of the companies to further pursue the proposal.

(d) Application in the High Court:

An application for approving the draft amalgamation proposal duly approved by the board of directors of the individual companies should be made to the High Court.

(e) Shareholders’ and creators’ meetings:

The individual companies should hold separate meetings of their shareholders and creditors for approving the amalgamation scheme. At least, 75 per cent of shareholders and creditors in separate meeting, voting in person or by proxy, must accord their approvals to the scheme.
(f) **Sanction by the High Court:**

After the approval of the shareholders and creditors, on the petitions of the companies, the High Court will pass an order, sanctioning the amalgamation scheme after it is satisfied that the scheme is fair and reasonable. The date of the court's hearing will be published in two newspapers, and also, the regional director of the Company Law Board would be intimated.

(g) **Filing of the Court order with registrar of Companies:**

After the Court order is sanctioned, its certified true copies will be filed with the Registrar of Companies.

(h) **Transfer of assets and liabilities:**

The assets and liabilities of the acquired company will be transferred to the acquiring company in accordance with the approved scheme, with effect from the specified date.

(i) **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.

2.6.2 **The Competition Act, 2002:**

The Act regulates the various forms of **business combinations** through **Competition Commission of India**. Under the Act, no person or enterprise shall enter into a combination, in the form of an acquisition, merger or amalgamation, which causes or is likely to cause an appreciable adverse effect on competition in the relevant market and such a combination shall be void. Enterprises intending to enter into a combination may give notice to the Commission, but this notification is voluntary. But, all combinations do not call for scrutiny unless the resulting combination exceeds the threshold limits in terms of assets or turnover as specified by the Competition Commission of India. The Commission while regulating a 'combination' shall consider the following factors:

(a) Actual and potential competition through imports;
(b) Extent of entry barriers into the market;
(c) Level of combination in the market;
(d) Degree of countervailing power in the market;
(e) Possibility of the combination to significantly and substantially increase prices or profits;
(f) Extent of effective competition likely to sustain in a market;
(g) Availability of substitutes before and after the combination;
(h) Market share of the parties to the combination individually and as a combination;
(i) Possibility of the combination to remove the vigorous and effective competitor or competition in the market;
(j) Nature and extent of vertical integration in the market;
(k) Nature and extent of innovation;
(l) Whether the benefits of the combinations outweigh the adverse impact of the combination.

Thus, the Competition Act does not seek to eliminate combinations and only aims to eliminate their harmful effects.

2.6.3 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.

2.6.4 SEBI Takeover Code 1994:

SEBI Takeover Regulations permit consolidation of shares or voting rights beyond 15 per cent up to 55 per cent, provided the acquirer does not acquire more than 5 per cent 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 per cent 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.

2.6.5 **The Indian Income Tax Act (ITA), 1961:**

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

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

b) Shareholders holding not less than 75 per cent of the value of shares in the transferor company (other than shares which are held by, or by a nominee for, the transferee company or its subsidiaries) become shareholders of the transferee company.

The following provisions would be applicable to merger only if the conditions laid down in section 2(1B) relating to merger are fulfilled:

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

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

(ii) In case of merger, cost of acquisition of shares of the transferee company, which were acquired in pursuant to merger will be the cost incurred for acquiring the shares of the transferor company. [Section 49(2)]
2.6.6 **Mandatory permission by the courts:**

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

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

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

2.6.7 **Stamp duty:**

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

In the pure sense of the term, a merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals." Both companies’ stocks are surrendered and new company stock is issued in its place. For example, both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created. In practice, however, actual merger of equals don't happen very often. Usually, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it's technically an acquisition. Being bought out often carries negative connotations, therefore, by describing the deal as a merger, deal makers and top managers try to make the takeover more palatable.

When one company takes over another and clearly establishes itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist, the buyer swallows the business and only the buyer’s stock continues to be traded. There are various types of mergers which take place, but broadly mergers can be classified into Horizontal Merger, Vertical Merger and Conglomerate Merger. These different types of mergers have different benefits like economies of scale, entry into an untapped geographic area / product line, etc which in turn result in synergistic advantage.

Synergy as the Driving Force

Synergy is the main principle behind a merger or an acquisition. When two companies together are more valuable than both of them separately, a merger of the two makes economic sense. Synergy is the magic force that allows for enhanced cost efficiencies of the new business. Synergy takes the form of revenue enhancement and cost savings. By merging, the companies hope to benefit from the following:

1) Staff reductions:

Merger helps the merged company to reduce redundant staff. People from executive and managerial cadre will usually be reduced as and where they are duplicated. This will save lot of money for the company.
2) **Economies of scale:**

Whether it's purchasing stationery or a new corporate IT system, a bigger company placing the orders can save more on costs. Mergers also translate into improved purchasing power to buy equipment or office supplies - when placing larger orders, companies have a greater ability to negotiate prices with their suppliers.

3) **Acquiring new technology:**

To stay competitive, companies need to stay on top of technological developments and their business applications. By buying a smaller company with unique technologies, a large company can maintain or develop a competitive edge.

4) **Improved market reach and industry visibility:**

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

### 2.8 Reasons for Failures of Mergers and Acquisitions:

Mergers and acquisitions are viewed as some magical strategies which would lead the company to great heights in terms of profit, market share, reach, product range, growth etc. However, it has been found in many cases that mergers and acquisitions have actually failed to create any value for the companies. Cited below are some of the major reasons why a Merger or an Acquisition between companies may not meet the expected results or may completely fail. The merger between two giant companies Daimler-Benz AG and Chrysler Corporation is a classic example.

Companies may think that by integrating the operations of two firms they may be able to achieve economies of scale, large size, bigger market share, slashed competition etc. but they fail to perceive certain other detrimental factors of integration related to people, organizational culture, differences in learning curves, overpayment etc.

**Major Detriments are:**

a) Being unable to carry out ongoing business while integration of companies is going on.
b) Lack of empathy and support from top management.

c) Inability of the top management to understand the impact of cultural issues on the merged entity.

d) Lack of communication within the two merged entities.

e) Lack of specific skills required to deliver results.

f) Ambitious targets set during acquisition plans are hard to achieve.

g) Overpayment for the target company.

h) Unfavorable economic conditions immediately post integration.

i) Incomplete or faulty due diligence.

j) Overdependence on debt for financing deals which leads excess debt servicing burden.

k) Reluctance to change.

l) Overindulgence and management laxity.

m) Conflict between stakeholders.

n) Bureaucratic and legal issues.