CHAPTER-VI
EMERGING DIMENSIONS IN THE FIELD
OF MERGERS AND ACQUISITIONS

6.1. Introductory

Every field when it evolves over a considerable period of time, new dimensions are gradually added to it. Any subject whether it is social, economic, political or legal changes with time or new aspects arise in it. So is with the subject of mergers and acquisitions. The area of mergers and acquisitions has gradually evolved over time due to its connection with rapidly evolving corporate sector. So in this chapter, we will have a look into the emerging dimensions in the field of M&As.

First dimension that has arisen post 2000 is with the globalisation of Indian economy-the rise of cross-border mergers in India. Growing Indian economy, liberalisation and relaxation of foreign policies, extra cash with Indian corporates have all contributed to rise in cross-border M&A in India.

Second dimension is the increasing importance of intellectual property rights in M&As. Growth and need to access new markets have dominated the 21st century companies which have resulted in huge scale M&As. Every business uses some form of intellectual property and the buyer of a business will need to acquire that intangible assets along with tangible one. These intellectual property assets embody much of a company’s competitive advantage in the market place. They are, in fact, driving force behind many mergers. In view of their immense importance in evolving knowledge economy, there is need to study the methods of valuation, due diligence and audit of intellectual property assets in M&A transactions.

Third and the last dimension which has been examined is the human dimensions in mergers and acquisitions should be given due care and weightage because they are often ignored which may lead to failure of mergers. The recent failure of Air-India-Indian Airlines merger has brought to the limelight the importance of human resources in M&A deals. The merger failed as the aircraft operators failed to properly integrate their human resources.
6.2. Rise of Cross-border Mergers and Acquisitions in India

The recent times have seen a number of ‘mega mergers’ between companies headquartered in different parts of the world, resulting in truly global enterprises. The rapid growth of the global economy with liberalised economic and legal environments has resulted in restructuring of commercial entities on profitable lines so as to withstand global competition and to strengthen the business to maximise shareholder value.

Cross-border mergers and acquisitions take place when two companies of different countries merge together. Company jurisprudence of almost all countries provides a legal mechanism to facilities such mergers as world trade integration and globalisation have spurred a wave of international mergers and acquisitions. International mergers and acquisitions may be regarded as a new cross-border strategy that aims at increasing corporate global competitiveness by pursuing related diversification and by integrating affiliates into a global network.¹

Types of International or Cross-border mergers are:

1. Inbound acquisitions i.e. acquisition of domestic corporations by Multinational Corporations (MNCs).
2. Outbound acquisitions i.e. domestic corporations that become global through the acquisition of corporations at home and abroad.
3. Mergers of multinational corporation that affect economies through effects on their subsidiaries.

One of the most vital and welcome dimensions and trends in the present scenario is increasing degree of internationalisation of global economy through M&As. Continuous development of global mindset has consequently resulted in an increase in the number of cross-border M&As.² The intensity of this form of restructuring is increasing with the deregulation of various government policies as a facilitator of the neo-liberal economic regime. India also could not lag behind.

In the current times doing business has become an increasingly dynamic process, as the business operates not in isolation but is affected by the economic, social, political, cultural and legal environment of the country. As a result, with ushering in of the era of liberalisation and the shackles of contrite regulations broken away, India has woken up to being a major player with the advent of globalisation. Realising the economies of scale to be gained as well as privatisation, globalisation and deregulation acting as necessary catalysts, cross-border M&A activities have increased in frequency in India. Thus the concept of cross-border M&A which gained popularity in US in 1970s have gained importance in India post 2000.

**Indian Scenario:** One of the beneficiaries of the continued globalisation, liberalisation and simplification of business has been the various sectors of Indian economy. From a small town trader running a family business, to the fearless and braving entrepreneur negotiating with multinational corporate powers to attract investment in his Indian business, or acquiring foreign competitors and raring to compete in the international arena, the image of corporate India has undergone a sea change in the past few decades. Surely the founding fathers of the TATA Group would not have dreamt about acquiring Ford, Jaguar Land Rover or cracking the deal with Corus. With the cross-border merger and acquisitions activity in India growing at an exponential rate, a stage has been set for several smaller business enterprises to take the plunge and this seems quite beneficial for the Indian economy.

The recent news report about Airtel acquisition of Zain Telecom, Tata Steel acquisition of Corus, Holcim’s acquisition of ACC and Vodafone acquisition of Hutchisson-Essar has brought M&A activity in the limelight again. It has also emphasised the fact that Indian M&As transactions are reaching global scale, in terms of size and reach. The rules of mergers and acquisitions are also changing and changing fast. It reflects that entities which fund business expansion activities (like M&A activity) are increasingly more willing to take the risk of the transactions, rather than provide debt at a fixed rate.

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of return. A well entrenched capital markets and ease of transactions contributes to smooth exits for private equity players, thus making India an even more attractive investment destination.\textsuperscript{5}

These and many such transactions have brought to the forefront the importance of cross-border Mergers and Acquisitions for both Indian and multinational companies. The companies have realised that organic growth needs to be supplemented by inorganic growth and ‘size does matter’ in the global business world. Thus, cross-border deals are becoming a regular feature of the Indian Mergers and Acquisitions landscape. The result being that foreign investment is seeing an unprecedented boom.

\textbf{6.2.1. Trends of Cross-border Mergers and Acquisitions in India}

Before 1990s, the number of cross-borders mergers were almost negligible or very little. The real impetus for M&As in India came from the economic reforms of liberalisation, privatisation and globalisation introduced by the government. With introduction of these economic reforms, the Indians companies were exposed to considerable degree of competition both domestic and international. They were therefore, required to restructure and re-engineer to increase efficiency and become more competitive. Within the constraints of cost involved in this reorganisation of business, the Indian corporate entities adopted inorganic route to growth.\textsuperscript{6} This lead to high tide of domestic as well as cross-border M&As in India.

Over the last few years, cross-border deals have been gathering considerable momentum. Indian companies see ‘going global’ as a strategic priority. The intensity of cross-border M&As has increased significantly during the period from 1995 to 2006. According to Accenture data, as depicted in figure 6.1 below, the number of such deals has increased from 30 in the year 1995 to 71 in the year 2000, an increase of 136 percent during the 5 year period. Further, the estimated cross-border M&A deals for 2006 is 183 which represents an aggregate increase of 510 percent during the entire period from 1995 to 2006. In fact, about three-quarters of acquisitions conducted by


\textsuperscript{6} “Analysis of Trends in Mergers and Acquisitions in India”, retrieved from http://shodganga.inflibnet.ac.in/bitstream/10603/12642/7/07_chapter%203.pdf, accessed on 11 October 2013 at 2.32 pm.
Indian companies since 2003 have been cross-border. The value of deals conducted by Indian companies grew at a compound annual growth of 28.3 percent over 2000-07 to reach US $30.4 billion in 2007 of which US $22.6 billion represented cross-border transactions. 29 percent of Indian cross-border M&As between 1995 and August 2006 occurred in the European Union and 32 percent in North America on account of larger consumer markets, transparent business processes, rule of law, advanced technologies, skills and knowledge capital.

6.2.1.1. Factors which Lead to Rise: The cross-border acquisitions by Indian companies is facilitated by number of important developments that have taken place in political and economic environment of Indian business. As already discussed before also, in 1999, the restrictive FERA was revised and the new FEMA was introduced to govern foreign exchange related transactions and provided incentives to companies to go global.

With introduction of FEMA, 1999, Indian companies were allowed to make overseas investments upto $15 million. In 2004, for instance, the Indian companies were permitted to make overseas investments upto 100 percent of their net worth, whether through joint ventures or a wholly-owned subsidiary. This will enable Indian companies to take advantage of global opportunities and also to acquire technological and other skills for adoption in India.

In 2005, RBI for the first time allowed Indian banks to lend money to Indian companies to make foreign acquisitions abroad. The ECB (External Commercial Borrowings) route opened during the same year to fund external FDI thus, providing further boost to

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cross-border M&As. As a result, more Indian cross-border deals are being financed, in whole or in part, by foreign banks. In 2006, Tata steel borrowed US $500 million in Singapore in a syndicated loan involving 17 banks to fund growth and acquisitions in Southeast Asia and China. In the same year, Suzlon Energy acquired the Belgium Company EVE Holding, for US $565 million, the deal was underwritten by Barclays Capital, Deutsche Bank and the Industrial Credit and Investment Corporation of India (ICICI) Bank.\(^{12}\) By 2010, Indian companies were permitted to invest up to 400 percent of their company’s net worth.

The major industries focused in cross-border M&As during 1995 to 2000 have been consumer goods and services, pharmaceuticals, healthcare and energy which together accounted for 66 percent of cross-border M&A activity.\(^{13}\) But this trend is changing post 2000, as industries as diverse as forest products, human resource and market-research are getting involved in cross-border M&As. But on top of all these, information technology, services, electronics and high technology industries accounted for more than half of cross-border transactions post-2000. The increase in share of information technology related sectors in total M&A is due to access to market, natural resources, distribution networks, foreign technologies and strategic assets like brand name. India has become a leader in information technology and was designated as the third most attractive research and development centre in the world by UNCTAD (United Nation Conference on Trade and Development) in its World Investment Report 2005.\(^{14}\) During the period 2001-07, highest number of acquisitions i.e. 105 (reported value for cost of acquisition US $2351 million) were in IT sector followed by consumer goods 25 (value US $1297 million), Pharma and healthcare 23 (value US $1571 million), chemicals 17 (value US $316 million) and the automotive industry 13 (value US $358 million). However, the big deals in term of average value are in Petroleum and Natural Gas Industry $240 million, Steel Industry $134 million followed closely by the Telecom Sector $127 million.\(^{15}\)

\(^{12}\) “India Finance: Banking on Growth”, Economic Intelligence Unit, 31 May 2006, p. 8.

\(^{13}\) “Analysis of Trends in Mergers and Acquisitions in India”, retrieved from http://shodganga.inflibnet.ac.in/bitstream/10603/12642/7/07_chapter%203.pdf, accessed on 11 October 2013 at 2.32 pm.

\(^{14}\) S. Majumdar, “Mergers and Acquisitions- India Inc. on the Prowl”, retrieved from http://www.blonnet.com, accessed on 31 May 2008 at 3.00 pm.

\(^{15}\) For details, see, “Corporate Sector: Mergers and Acquisitions”, Monthly Review of Indian Economy, Economic Intelligence Service, Centre for Monitoring Indian Economy (CMIE), New Delhi, 2007.
In addition to this, in the past few years, Indian companies are increasingly looking at offshore acquisitions as means of growth. The ‘Indian story’ has seen a profound shift in gear and direction in recent years. While pre 2005, most media references to India’s growth have focused on the sub-continent as a destination for outsourcing and investment, past few years have seen the arrival of India as a shaping force in global markets.

This is particularly evident in the powerful new trend towards overseas acquisitions by Indian companies. Until a few years ago, news of Indian companies having acquired American-European companies were seldom heard. However, this scenario has a sudden change. Buoyant Indian economy, extra cash with Indian corporates, their ability to raise relatively large funds at low costs, helpful government policies and new found dynamism in Indian businessman have all contributed to a new acquisition trend. A few large transactions worth mentioning are Bharti Airtel acquisition of the telecom business of Zain in Africa and Warid in Bangladesh, Hindalco acquisition of Novelis, Infosys buys Axon group, Tata buys Jacquar and Land Rover, Essar Steel’s acquisition of Algoma Steel, Tata Tea acquired Tetley Tea of UK and Eight o’Clock Coffee of USA, Dr. Reddy’s Lab acquired the Betapharm of Germany, Videocon bought Daewoo Electronics Corporation for $729 million and Suzlon Energy Ltd. acquired German firm Repower Systems AG for $1.7 million. Let’s not forget to mention about the Oil and Natural Gas Corporation’s takeover of Imperial Energy Plc for $2.8 billion in January 2009. Thus, this rise in cross-border M&A is a key factor helping Indian companies to emerge on the global stage. Apollo Tyres acquiring US based Cooper Tire and Rubber Co., a company nearly three times its size in June 2013 via an all-cash transaction valued at approximately Rs.14,500 crore is a recent example of ‘big ambitions’ of Indian companies. With this deal, Apollo Tyres will be a true

18 For details, see, Vijay Kumar Sharma and Rakesh Kumar Sharma, “Cross-border Merger and Acquisition with Special Reference to India”, retrieved from http://www.indianmba.com/faculty column/fc720/fc720.html, accessed on 10 October 2013 at 11.08 pm.
MNC overnight with 14 plants spread across India, the United States, China, Europe and Mexico. Apollo will have market presence not only in the US and EU, but it will also have foothold in fast growing markets like China, Africa and Latin America. The deal would make Apollo Tyres the world’s seventh largest tyre maker and reduce its dependence on a slowing Indian auto market where car sales declined by 7 percent in the financial year ending in March 2013, the first annual fall in a decade.\(^{19}\)

The beginning of 2007 saw the signing of the largest inbound deal in India’s history, Vodafone’s $11.1 billion acquisition of a 67 percent controlling interest in Hutchinson-Essar, India’s fourth largest mobile phone company and in 2008, Daiichi Sankyo acquired Ranbaxy for Rs.15000 crore. Special mention should be made of US based soft drink major Coca Cola buying Parle’s Thums Up, Limca and Goldspot brands, Gillete taking over Indian shaving products, NTT Docomo’s acquisition of 26 percent stake in Tata Teleservices Ltd. for approximately $2.7 billion,\(^{20}\) Abott’s acquisition of healthcare business of Piramal Healthcare for a price of $3.72 billion in 2010,\(^{21}\) Watson Pharmaceuticals acquiring Ascent Pharma in a cash deal worth $ 370 million,\(^{22}\) and last but not the least, Diageo Plc acquiring 53.4 percent stake in United Spirits Ltd. in 2012. All these deals, headlined a frenzy of acquisitions in India by MNCs abroad.

Such spectacular overseas acquisitions by Indian companies in such a short span of time show that Indian companies are beginning to play the merger and acquisition game as well as any large multinational from the developed world.\(^{23}\) There are four key drivers for Indian companies considering overseas acquisition. They are:\(^{24}\)

**I) The Need to Capture New Market:** The key motivation for going global is to find new markers to sustain top-line growth.

\(^{19}\) "India Inc. Gearing up for a Season of Mergers and Acquisitions", retrieved from http://www.projectstoday.com/Week At Glance/India-Inc-gearing-up-for-a-season-of-mergers-and-acquisitions, accessed on 5 October 2013 at 3.05 pm.


\(^{21}\) Economic Times, 9 September 2010, as quoted in Ernst and Young, 2012, p. 9.

\(^{22}\) Hindu Business Line, 24 January 2012, as quoted in Ernst and Young, 2012, p. 9.


(2) The Need to Expand Capabilities and Assets: Many Indian companies are seeking to expand their distinctive capabilities by acquiring specific skills, knowledge and technology abroad, which are either unavailable or of inadequate quality in India. For example, Sun Pharmaceutical Industries acquired Able Laboratories Inc. of New Jersey for US $23.15 million in December 2005 to gain to its in-house manufacturing and development capabilities for generic pharmaceutical products. Another example is that if i-flex, the software company based in Mumbai, paid US $11.5 million to US based Super Solutions Corporation to access technology that is widely used in US banks. In this way, Indian companies can assimilate technologies that have been tried and tested abroad.

(3) The Need to Expand Product or Service Portfolios: Most Indian companies are endeavoring to increase market share by building the size of their product and service portfolios.

(4) The Pressure of Domestic Competition: As well as pursuing the desire to enter new markets for competitive advantages, some companies are being ‘pushed away’ from India by increasingly stiff domestic competition. In some cases, this has encouraged companies to explore opportunities in less competitive markets, thereby spreading their risk across geographies. But on the other hand, some companies look outside India to avoid domestic obstacles. Examples that can be quoted here is of Indian pharmaceutical companies who prefer to carry out certain stages of clinical trials in developed markets because of the delays that occur due to our lengthy bureaucratic processes despite low cost advantages of conducting clinical trails in India.

Whereas UNCTAD in its World Investment Report 2006 has pointed out four factors that drive developing nations like India to go global.

1. It helps market penetration Indian Multinational Corporations looking for niche markets such as IT services and pharmaceutical products gained substantially through outbound investments.

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25 Ibid.
26 Ibid.
2. Rising labour costs at home push MNCs abroad.

3. Competitive pressures in the domestic economy force MNCs to invest abroad.

4. Home government policy liberalisations stimulate outbound investments. As the Industrial Policy 1991 of the Government of India liberalised the Indian economy by doing away with excessive and restrictive government controls and licensing with a view to promote foreign investment in India which lead high tide of cross-border mergers in India.

6.2.1.2. **Outbound vs. Inbound:** The value of Indian outbound deals was US $ 0.7 billion in 2000-01, increased to US $ 4.3 billion in 2005 and further crossed US $ 15 billion-mark in 2006. In fact, 2006 will be remembered in India’s corporate history as a year when Indian companies covered the globe and acquired a number of strategically significant companies. Cross-border M&As constituted 60 percent of the total M&As activity in India in 2006. And almost 99 percent of acquisitions were made with cash payments.  

The ‘Indian Story’ has seen a profound shift in gear and direction during 2006 as this year has seen the arrival of India as a shaping force evident in the powerful new trend towards overseas acquisitions by Indian companies. Indian cross-border mergers and acquisitions is the search for top-line revenue growth through new capabilities and assets, product diversification and market entry. The steep increase in the number of major cross-border transactions in recent years - from 40 in 2002 to 264 in 2007 and 289 in 2010 (also see figure 6.1) has been facilitated by the relaxation of regulations on overseas capital movements as well as a more supportive political and economic environment, including deeper currency reserves and easier access to debt-financing, both at home and from international banks. This M&A trend is a key factor helping Indian companies to emerge on the global stage.

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Table 6.1: Trends of Cross-border Purchases and Sales from 2005 to 2012.

(Million of Dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cross border sales</th>
<th>Cross-border purchases</th>
<th>Total cross border deals</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-07 (Pre-crisis annual average)</td>
<td>3119</td>
<td>12,558</td>
<td>15677</td>
</tr>
<tr>
<td>2008</td>
<td>10427</td>
<td>13482</td>
<td>23909</td>
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<tr>
<td>2009</td>
<td>6049</td>
<td>291</td>
<td>6340</td>
</tr>
<tr>
<td>2010</td>
<td>5550</td>
<td>26698</td>
<td>32348</td>
</tr>
<tr>
<td>2011</td>
<td>12886</td>
<td>6137</td>
<td>19023</td>
</tr>
<tr>
<td>2012</td>
<td>2474</td>
<td>2650</td>
<td>5124</td>
</tr>
</tbody>
</table>

Source: UNCTAD, World Investment Report, 2013.\(^{30}\)

Fig. 6.1: Cross-border deals of Indian Companies from 1995 to 2012.\(^{31}\)

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The confidence within the Indian business community, combined with its natural entrepreneurial zeal and intuitive ease with global business models, creates a formidable force. India’s economic liberalisation in 1991 sparked fears that the country would be overrun by foreign multinationals. However, Indian companies have not only managed to fight off competitors on their home ground, they have also taken the commercial battle abroad.\(^{32}\) In 2006-07, it was expected that Indian M&A will accelerate dramatically. But due to recession in US economy and Euro zone crisis, India was also impacted. The number of cross-border deals came down to 156 in 2009. Their was recovery in 2010 and 2011 as evident from figure 6.1 and Table 6.1.

But the global economic headwinds such as uncertainties pertaining to the Eurozone, the slow recovery of the US economy, retroactive taxation and introduction of GAAR has marred cross-border M&A activity in India in 2012. The number of deals came down to 190 in 2012. The value of deals also came down to US $5124 million in 2012 from US $32,248 in 2010 (see Table 6.1).

This downslide was also due to slowdown in reforms, rising interest rates, the depreciating rupee, slow GDP growth and the regulatory environment.\(^{33}\) But in the midst of a declining domestic growth rate, Indian companies have reigned their interest in M&A activities, especially is cross-border mergers in 2013. M&A activity surged by 12.13 percent in first half of 2012.\(^{34}\) Easy accessibility and the low cost of debt capital through financial institutions in the international market are prime factors leading to the maximum number of overseas acquisitions by Indian companies.

Another visible trend recently in cross-border M&A is the shift in focus from outbound to inbound deals. Inbound M&A value jumped 190.4 percent from first quarter of 2013


\(^{33}\) Changes in regulatory environment negatively impacting M&A activities include amendments in Competition Act, 2007, new CCI regulations, retrospective tax amendments and new GAAR provisions.

\(^{34}\) “India Inc. Gearing up for a Season of Mergers and Acquisitions”, retrieved from http://www.projectstoday.com/Week At Glance/India-Inc-gearing-up-for-a-season-of-mergers-and-acquisitions, accessed on 5 October 2013 at 3.05 pm.

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(US $2.3 billion) to second quarter of 2013 (US $6.8 billion). In the researcher’s view, the key reasons for this trend are:

- Uncertainty over the economic stability of European Union and its effects globally.
- Growing domestic market making Indian targets more attractive.
- Weak Indian rupee that has made the Indian businesses attractive.
- Strategic shift in the behavioural pattern of Indian entrepreneurs coupled with attractive valuations from foreign players and the significant growth opportunities in India, are prompting Indian entrepreneurs to evaluate exits.

In the researcher’s view, there is a significant shift in attitude and behaviour of Indian entrepreneurs who have the open mind to evaluate strategic buyers to exit their age-old businesses and this trend is expected to continue. Illustrations of such successful exits by Indian promoters include Daiichi-Ranbaxy and Abbott-Piramal. Moreover, British Petroleum’s acquisition of equity stake in Reliance Industries (one of the largest deals of 2011), demonstrates the desire of Indian promoters to bring in foreign technology and capital to enhance business capabilities. In the researcher’s view, the era of global collaborations and partnerships would become even more vital now than ever before.

To sum up, even though the current environment is really challenging both from economic and regulatory perspectives, the long-term outlook on cross-border M&As in India will be robust.

6.2.2. Cross-border Mergers and Acquisition: The Rising Mode of FDI Entry Across the Globe and in India

Over the last two decades, the share of cross-border M&As in the global FDI inflows, has been an impressive 56 percent. Because earlier, foreign firms were satisfying their market expansion strategy through the setting up of wholly owned subsidiaries in overseas markets which has now become a ‘second best option’ since its involves much time and effort that may not suit to the changed global scenario, where the watchword is ‘placation’, that is plan and action together. Thus, cross-border M&As became the first

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best option. The same happened in India, the Indian corporate sector too experienced a boom in cross-border M&As after liberalisation of Indian economy in 1991.\textsuperscript{36}

Initially the share of cross-border inbound deals was only 2 percent of the FDI inflows to India, which is now near 14 percent in 2010. From 1990 to 2010, it constituted nearly 26 percent of the total FDI inflows in the country. No doubt, FDI through Greenfield investment is more as compared to FDI through cross-border inbound deals, but if we see UNCTAD data,\textsuperscript{37} it was quite high in some years, for example, in the year 1999 it was 42.4 percent, in 2004 it was 40.7 percent and in 2005 it was almost 70 percent. Thus, the significance of cross-border inbound deals as a source of FDI cannot be underestimated, atleast for the imminent future of the Indian corporate sector. Even though the share of Greenfield investment dominates almost the entire period, the contribution of cross-border M&As was very high in some years, for example, in the year 1999 it was 42.4 percent and in 2005 it was almost 70 percent.

6.2.3. Reasons for Cross-border Mergers and Acquisitions

Cross-border M&As can be seen as a kind of hybrid between a domestic and a foreign corporate. They have become topics of interest mainly because they help a firm to enter new international markets and thereby enhance their ability to compete in global markets.\textsuperscript{38} In general, cross-border M&As are a quick pathway to enter a new market, permit the acquiring firm to achieve critical mass presence in a market rapidly and result in more control as compared to other market entry modes.\textsuperscript{39} Some of the prominent reasons for the firms to complete cross-border M&A are as follows:

(1) **Growth:** To escape small home market, to extend markets served, to achieve economy of scale.

(2) **Inputs:** To access raw materials, to ensure consistent supply, to access technology, to access latest innovations, to access cheap and productive labour.


\textsuperscript{37} UNCTAD and FDI/TNC Database, retrieved from \textsuperscript{38} UNCTAD and FDI/TNC Database, retrieved from \url{www.unctad.org/fdistatistics}, accessed on 4 September 2011 at 11.24 am.


\textsuperscript{39} *Ibid.*
(3) **Exploit Unique Advantages:** To exploit the company’s brands, reputation, design, production and management capabilities.

(4) **Competition:** To diversify across products and markets, to reduce earning volatility, to reduce dependence on exports, to avoid home country political and economic instability, to compete with foreign competitors in their own territory, to circumvent protective trade barriers in the host country.

(5) **Client Needs:** To provide home country clients with service for their overseas subsidiaries, e.g. banks and accountancy firms.

(6) **Opportunities:** To exploit temporary advantages, e.g. a favourable exchange rate making foreign acquisitions cheap.

(7) **Barrier against Hostile Takeover:** Firms may pursue mergers and acquisitions for the sole reason of growing in size as size more than profitability or relative efficiency is considered to be effective barrier against hostile takeover.

Moreover, international acquisitions are a better form of foreign direct investment than establishing a new subsidiary. Through an international acquisition the firm can immediately expand its international business since the target is already in place. Conversely, establishing a new subsidiary requires time. Second, an international acquisition can benefit from the customer relationships that have already been established. Mergers and acquisitions, just like any other potential or actual anti-competition behaviour, cooperative agreements, abuse of dominant positions, are no respecters of borders. It is therefore clear that international cooperation is necessary to deal effectively with cross-border competition problems. The agreement signed in 1991 and put into effect by 1998 between the European Union and the United States is a good example of such cooperation. The agreement particularly facilitates the exchange of information and a transatlantic cooperative regime between the competition authorities and is applicable to mergers and acquisitions.

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41 Ibid.
6.2.4. Difficulties in Cross-border Mergers

Cross-border acquisitions may look interesting and sound impressive but are difficult and complex. The essential difference between an internal mergers and cross-border transactions is that the evaluation process is even more complex and requires a detailed analysis of not just the target company and industry but also the country (its economic and political situation). Moreover, cross-border requires familiarity and with new procedures and frameworks involving regulatory bodies, tax authorities and new accounting practices. In short, a cross-border transaction require information and knowledge of both the business climate as well as legal framework. Moreover, acquirer has to face problem related to difference in culture, language and business style.

6.2.5. Policy Changes and Regulatory Reforms

Post independence for about 10 years India was receptive towards foreign investment due to various reasons. Thereafter, due to change in policies, India became a closed economy. Hence, it became nearly impossible for an Indian business firm to think of inviting foreign investment, leave alone investing abroad. The concept of mergers gained popularity in India after the government introduced the new economic policy in 1991, thereby paving the way for economic reforms and opening up a whole lot of challenges both in the domestic and international spheres. The Industrial Policy 1991 of the Government of India was instrumental in liberalising the Indian economy by doing away with excessive and restrictive government controls and licensing with a view to promoting foreign investment in India. The Government embarked on a series of initiatives in respect of liberalising the policies relating to the following areas:

- Industrial licensing;
- Foreign investment;

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43 Bijesh Thakkar and Gautam Bhatt, December 2006, p. 5.
• Foreign technology agreements;
• Public sector policy; and
• The Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act) (now began replaced by the *Competition Act, 2002*).

In 1991, the restrictive provisions of the Monopolies and Restrictive Trade Practices (MRTP) Act relating to licensing for expansion of enterprises, amalgamations and takeovers of business enterprises and acquisition of foreign technology and foreign investment were removed. This was done as these restrictions hampered the expansion, diversification and upgradation of technology required for international competitiveness. The Foreign Exchange Regulation Act, 1973 (FERA) was substantially altered in early 1993. All restrictions on FERA companies in the matter of borrowing funds or raising deposits in India as well as taking over or holding stakes in Indian companies were removed. Indian companies and Indian nationals were allowed to start joint ventures abroad and accept directorships in overseas companies—something hitherto prohibited. A number of reform initiatives in the financial sector accompanied these changes. New capital issues were completely deregulated. Private mutual funds and Foreign Institutional Investors were allowed to enter the capital market.47 While deleting regulatory provisions under the MRTP Act, the government set up the Securities and Exchange Board of India (SEBI) under the SEBI Act, 1992 which was responsible for framing guidelines and rules regarding many aspects of corporate behaviour. Thus Securities and Exchange Board of India (SEBI) came out with a Regulation namely, Substantial Acquisition of Shares and Takeovers in 1994. These regulations, however were further revised in 1997 and 2011. It is now clear that this structural adjustment programme and the new industrial regime adopted by the Government of India allowed business houses to undertake, without restriction, any programme of expansion either by entering into a new market or through expansion in an existing market.

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Thus, the removal of policy and regulatory obstacles has been an essential first step in opening up global expansion opportunities for Indian companies. The rhetoric and legislation of Indian policy makers has encouraged overseas expansion as discussed above.

6.2.6. Role of WTO in Promoting Cross-border Mergers and Acquisitions

World Trade Organisation came into being on 1\textsuperscript{st} January 1995 for implementing its various provisions agreed upon by all the 148 member nations.\textsuperscript{48} Its main function is to ensure that trade flows smoothly and freely.\textsuperscript{49} The World Trade Organisation is the only international body dealing with the rules of trade between nations. The WTO agreement has been negotiated and signed by the bulk of the world’s trading nations. These documents provide the legal ground rules for international commerce. They are essentially contracts binding governments to keep their trade policies within agreed limits.\textsuperscript{50} As of result of their WTO commitments, countries agreed to open their markets for trade in goods or services.

The process of globalisation and liberalisation was expedited with the establishment of World Trade Organisation. Establishment of World Trade Organisation ushered in a new era of global economic co-operation reflecting the wide spread desire to operate in a fairer and open multilateral trading system.\textsuperscript{51} The process of globalisation and liberalisation which was accelerated by WTO lead to rise in cross-border mergers in India. Globalisation lead to integration of Indian economy with the world economy, whereas the main aim of liberalisation in India was to dismantle the excessive regulatory framework that curtailed the freedom of enterprise. The major purpose of liberalisation in India was to free the large private corporate sector from bureaucratic controls. It, therefore, started dismantling the regime of industrial licensing and


\textsuperscript{50} For details, see, The Institute of Company Secretaries of India (ICSI), \textit{World Trade Organisation International Trade Joint Ventures and Foreign Collaborations}, Taxmann Publications (P.) Ltd., New Delhi, 2004, p. 2.

controls. The industries reserved for public sector were reduced to bare minimum. Private sector could also enter into core industries like iron and steel, electricity, air transport, ship-building, heavy machinery and defense goods. As a result of liberalisation process initiated due to India’s obligations to WTO, private sector was freed from many regulations such as licensing, regulation on price and distribution, restriction on investment by large business corporate groups and granting permission to impart raw materials.  

Due to WTO, the governments throughout the world have embraced the open-trade policies with thrust on Foreign Direct Investment and export promotion through liberalisation. The free trade regime under WTO had a positive impact on cross-border M&As. The liberalised economic policies introduced by the Government of India in 1991 and formation of WTO have exposed Indian industry to several challenges and in response to this, the Indian economy has witnessed a sharp increase in mergers including cross-border mergers of companies.

Moreover, being a signatory to the World Trade Organisation, India was also required to remove some restrictions on FDI (Foreign Direct Investment) in future according to the provisions of TRIMs (Trade Related Aspects of Investment Measures) and, it did not fail to keep it obligations and further reforms with regard to FDI have come into force from time to time. FDI flow which stood at 97 million dollars in 1990-91 increased to 11,963 million dollars in 1998 to 36000 million dollars in 2011-12. Further, the draconian and restrictive Foreign Exchange Regulation Act, 1973 was amended, repealed and replaced by Foreign Exchange Management Act, 1999 (FEMA). FEMA was enacted to amend the law relating to foreign exchange with the objective of facilitating external trade and payments and to promote the orderly development and maintenance of the foreign exchange market in India.

Thus, to conclude we can say that the process of liberalisation and globalisation which was accelerated in India due to its obligations to WTO lead to high tide of cross-border mergers and amalgamations in India.

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52 Id., p. 126.
53 Id., p. 127.
54 “Luring Foreign Direct Investment, the Indian Way”, The Tribune, 9 April 2000, p. 15.
6.2.7. Applicable Law in Cross-border Mergers

Mergers and acquisitions are used as a means to achieve crucial growth and are becoming more and more accepted as a tool for implementing business strategy, whether they involve Indian companies wanting to expand or foreign companies wishing to acquire market share in India. A merger is required to comply with multiple regulations, non-compliance of which may lead to civil penalties or even civil prosecution under these regulations. When it comes to cross-border mergers, the number of regulations requiring compliance increase by two fold, considering the fact that regulations of more than one country govern such mergers.\textsuperscript{55} In India, the relevant laws that may be implicated in case of cross-border merger or acquisitions are as follows:

1. Company Law
2. Income Tax Law
3. Foreign Exchange Laws
4. Competition Law
5. Takeover Code Implications

As income tax law, competition law, company law, takeover code has already been discussed for cross-border mergers, so here we will focus our attention on foreign exchange laws and company law aspects of cross-border mergers. Company law aspects of cross-border mergers were not dealt in elaborately previously, so here we will have a look at them.

\textbf{(1) Company Law:} As the provisions of company law dealing with mergers and amalgamations have already been discussed previously, so here we will focus on those aspects of company law, which specifically deal with cross-border mergers. In cross-border M&A both amalgamating and the amalgamated company are required to comply with the requirements of section 391-394 of the Companies Act, which \textit{inter-alia}, require the approval of a High Court and the Central Government.

Basically, its section 394(4)(b) of the Companies Act, 1956 that applies to cross-border mergers and acquisitions. Section 394(4)(b) states that the transferee company must be a company within the meaning of the Companies Act (i.e., an Indian company) whereas the transferor company may be any body corporate whether a company within the meaning of the Companies Act or not. A ‘body corporate’ includes a company incorporated outside India. Thus, under the preview of section 394, a foreign company can amalgamate/merge into an Indian company with the sanction of the court but not vice-versa. Thus, on an apparent consideration of Section 394(4)(b), it seems that a transferee company has to be a company registered under the Act.

This provision acted as a hindrance in the case of cross-border M&As and was considered to be one of the major lacunas in the law. Even the report of the Expert Committee on Company Law, 2005 (Irani Committee Report) recommends that:

“A forward looking law on mergers and amalgamations needs to also recognise that an Indian company ought to be permitted with a foreign company to merge. Both contract based mergers between an Indian company and a foreign company and court based mergers between such entities where the foreign company is the transferee needs to be recognised in Indian Law. The committee recognises that this would require some pioneering work between various jurisdictions in which such mergers and acquisitions are being executed/created.”

Therefore, our recently enacted Companies Act, 2013 has incorporated this provision and allows for cross-border mergers, whereas the Companies Act, 1956 permits merger of foreign companies with companies registered in India but not vice versa. The 2013 Act permits merger of Indian company with foreign companies as well. The foreign company can merge into a company registered under this act or vice versa but with the prior approval of National Company Law Tribunal and Reserve Bank of India. The consideration to shareholders of the amalgamating company may be discharged by payment of cash or issuance of Indian Depository Receipts or a combination of both.

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56 Section 2(7) of the Companies Act, 1956.
58 Section 234(2) of the Companies Act, 2013.
59 Ibid.
The Central Government will notify the jurisdiction of the foreign company which are allowed for such cross-border mergers.\footnote{Section 234(1) of the Companies Act, 2013.}

(2) \textit{The Competition Act, 2002}: In pursuit of globalisation, India has opened up its economy, removing controls and resorting to liberalisation. The result was that the Indian market had to face competition from both within and outside the country. The competition implications of cross-border mergers has already been discussed before in the chapter of ‘Competition Act and its impact on Mergers and Acquisitions’.

(3) \textit{The Tax Laws}: As important corporate activities, the cross-border M&As are also regulated and governed by the provisions of the Income Tax Act, 1961 which have already been explained earlier.

(4) \textit{The Securities Laws of India}: In India, takeovers and acquisitions are governed by the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. These regulations seek to regulate the whole process of acquisitions and takeovers, based on principles of transparency, fairness and equal opportunity for all. So any foreign company desirous of acquiring an Indian company has to comply with these regulations which have been elaborated before in the chapter ‘Legal and Regulatory Framework for Takeovers and Acquisitions’.

(5) \textit{Foreign Exchange Laws}: As already stated, the Indian legal system governs cross-border M&A by a set of laws which includes the Foreign Investment Policy of the Government of India along with press notes and clarificatory circulars issued by the Department of Investment Policy and Promotion, the Foreign Exchange Management Act, 1999 and regulations made there under, including circulars and notifications issued by the RBI from time to time, here in after together referred to as the ‘FEMA Laws’.

\textbf{6.2.8. The Foreign Direct Investment Policy of India}

India’s story with respect to exchange control is one of a gradual, deliberate and carefully monitored advance towards full capital account convertibility. Through significant controls have been removed and foreign companies can freely acquire Indian companies across most sectors, these are subject to strict pricing and reporting
requirements imposed by the Reserve Bank of India. But still, nothing can stop us from saying that the FDI regime has been progressively liberalised, largely by removing the restrictions on foreign investment and simplifying procedures. As a result, among the emerging economies, India has one of the most liberal and transparent foreign investment regimes.

The foremost aspect of the Indian legal scenario that any foreign entity desirous of acquiring an Indian company must pay attention to the foreign direct investment norms. The latest FDI policy was notified by the Government of India vide FDI circular of 1 of 2013 which was effective from 5 April 2013. Further, the Reserve the Bank of India releases every year master circulars which contain the regulatory framework and instructions issued by RBI on a particular subject.

6.2.8.1. **Permitted Shareholding Norms:** India has the most liberal and transparent policies on Foreign Direct Investment (FDI) among the emerging economies. In most sectors of business, foreign investment is permitted upto 100 percent of the share capital of a company. In some other sectors (such as telecom 74 percent) sector specific guidelines are set out by the government from time to time. A foreign entity proposing to invest in India first needs to determine the sectoral cap in the area in which investment is proposed.

Currently, FDI is permitted in almost all the sectors except the following:

(a) Lottery business

(b) Gambling and betting

(c) Chit funds

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63 Bijesh Thakkar and Gautam Bhatt, December 2006, p. 5.

64 Department of Industrial Policy and Promotion, “Consolidated FDI Policy 2013”, Ministry of Commerce and Industry, Government of India, Circular 1 of 2013, w.e.f. 5 April 2013, (D/o IPP F.No. 5(1)/ 2013 –FCI), dated 5 April 2013.
(d) Nidhi company

(e) Real estate business

(f) Activities/sectors not open to private sector investment e.g. Atomic Energy and Railway Transport (other than Mass Rapid Transparent System).

(e) Trading in Transferable Development Rights (TRRs)

(g) Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

In an international merger or acquisition, one can invest in India only as permitted under the FDI policy. Once it is determined that the FDI is being brought in a sector which is not prohibited under the FDI policy, the same shall be brought in India either under:

1. **Automatic Route:** The government of India has placed most of the areas or activities for the purposes of FDI, under the automatic route for investment. Under the automatic route both the Government of India (GOI) and the Federal bank of India i.e. RBI permit Indian companies to accept FDI without obtaining any prior approvals. Certain conditions will have to be complied:

   (i) **Reporting Receipt of Funds:** The domestic company shall submit a report within 30 days from the date of receipt of inward remittances in an advance reporting form.

   (ii) **Reporting Issue of Shares:** After the issue of shares, the Indian company should file a report in form FC-GPR not later than 30 days from the date of issue of shares, with the regional office of RBI where the registered office of the company is situated. Further, the equity or equity linked instruments should be issued within 180 days from the date of receipt of the inward remittance. In the case of transfer of shares from a resident to a non-resident or vice versa such transfer of shares need to be notified to the RBI within 60 days from the date of such transfer. International financial institutions may also invest in domestic companies through the automatic route but the same is

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subject to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011 and RBI regulations and sector specific limits (if applicable) as discussed below. For most sub-heads finding mention under the automatic route, including *inter alia*, investment in power, construction, development projects and non-banking finance companies (subject to certain conditions such as minimum capitalisation norms that are prescribed for financial services sector), manufacturing activities, venture capital funds, the GOI has permitted FDI up to 100 per cent or all of the capital requirements.  

For the remaining sub-heads listed under the automatic route, FDI is permitted up to prescribed percentages or sectoral caps qua the specific sector. FDI is excess of the sectoral caps require the prior approval of the GOI. For instance, FDI in the case of ‘Airports’ (existing projects as opposed to greenfield projects) is permitted up to 74 per cent of the capital requirements under the automatic route, however FDI in excess of the 74 per cent prescribed percentage would require prior approval from the GOI.

(2) Approval Route/Non Automatic Route: All activities, which are not covered under the automatic route and are not prohibited require a prior approval of the Government of India. Further, FDI in areas which do not fall under the automatic route or where the proposed FDI exceeds the specific sectoral caps requires the prior approval of the Government of India through its Foreign Investment Promotion Board (FIPB).

Further, even in sectors where 100 percent FDI is permitted, the prior approval of the Foreign Investment Promotion Board (FIPB) would be required if:

- Where provisions of press note 1 (2005) are attracted
- Where more than 24 percent foreign equity is proposed to be inducted for manufacture of items reserved for the small scale sector.
- Where foreign investment is made into an Indian company engaged only in the activity of investing in the capital of other Indian companies, regardless of the amount or extent of the foreign investment.

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68 Ibid.
69 Ibid.
70 Seth Dua & Associates, 2011, p. 357.
71 Bijesh Thakkar and Gautam Bhatt, December 2006, p. 5.
72 Ibid.
73 Ernst and Young, 2012, p. 235.
• Infusion of foreign investment into an Indian company that does not have any operations or any downstream investments, regardless of the amount or extent of the infusion.\footnote{Ibid.}

Additionally, investments in certain specific sectors including broadcasting, aviation, publishing, defense production etc are subject to guidelines issued by relevant ministerial departments and also requires the prior approval of the FIPB.

Application for such cases are to be submitted in FC/IL form or on plain paper to Foreign Investment Promotion Board in Department of Economic Affairs, Ministry of Finance,\footnote{Anni Singh and Himani Sharma, 2009, p. J3.} while non-resident Indians, Export Oriented Units (EOUs) and retail trading (single branded products) are required to submit their proposals to the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion, Government of India for consideration of FIPB.

The recommendations of FIPB in respect of proposals falling in the non-automatic route and involving an investment of Rs. 12000 million or less are considered and approved by the Finance Minister. However, for projects with an investment greater than Rs. 12000 million are submitted by FIPB to the Cabinet Committee on Economic Affairs for further approval.\footnote{Ernst and Young, 2012, pp. 235-236.} When once the approval of Government of India is received, no further approval is required from the RBI, that accords a general permission to such proposals. But the details of the GOI approval should be made available to RBI alongwith reports intimating the receipt of funds.\footnote{Seth Dua & Associates, 2011, pp. 357-358.}

In terms of FDI policy, in cases of investment by way of swap of shares (i.e. exchange of shares of Indian company in return of shares of the foreign investing company), irrespective of the amount, valuation of the shares needs to be done by a Category I merchant banker registered with SEBI or an investment banker outside India registered with the appropriate regulatory authority in the host country.\footnote{FICCI, “Evolving Dynamics in India’s M&A Landscape”, retrieved from \url{http://www.ficci.com/events/21076/knowledge-paper-M&A-final.pdf}; accessed on 2 March 2013 at 3.15 pm.} If investment is by way of swap of shares, approval of FIPB is a prerequisite.
6.2.8.2. Discretion of FIPB: When an application is filed before FIPB, which can be online also, if it grants permission, it will issue an approval letter. But grant of the approval by FIPB is discretionary and is granted on the merits of each investment proposal and based on prevailing government policies. But if the permission is granted, the terms and conditions of the said permission are binding both on the investing company as well as on the Indian investee company. Upon securing the FIPB approval, the Indian company may than arrange to receive the investment from and issue shares to the foreign investor.  

6.2.8.3. Foreign Persons who can make Investment in India under FDI Regime:

1. A non-resident entity (other than a citizen of Pakistan or Bangladesh or an entity incorporated in Pakistan or Bangladesh) can invest in India subject to compliance with the extant FDI regulations.

2. A person who is a citizen of Bangladesh or Pakistan or an entity incorporated in Bangladesh or Pakistan can invest in India under the FDI provisions, subject to receiving the prior approval of the Government (FIPB).

3. Earlier, only citizen of Bangladesh or entity incorporated in Bangladesh was allowed to invest subject to government approval, but by the FDI policy 2013, citizen of Pakistan or entity incorporated in Pakistan is also allowed to invest in India subject to receiving prior Government approval.

6.2.8.4. Key Policy Considerations: In view of the policy, as discussed aforesaid, the following considerations play a key role in determining the manner in which FDI can be brought in India.

1. Sector in which FDI is proposed.

2. Whether the FDI is under the automatic route or non-automatic route.

3. Whether the foreign party proposing to invest in India has an existing joint venture or tie up/trademark/technology collaboration agreement with a domestic Indian company in the same field.

79 Ibid.
80 Ernst and Young, 2012, p. 222.
4. Whether FDI is proposed to be made into a new company or an existing company.

6.2.8.5. Issuance of Shares by the Transferee/Amalgamated Company: As a general consequence of a merger, there is an issue of shares by the amalgamated company to the shareholders of the amalgamating company. As per the current FDI policy,\(^\text{82}\) where a scheme of merger of two or more Indian companies or a reconstruction by way of demerger or otherwise of an Indian company has been approved by a court in India, the transferee company or, as the case may be the new company may issue shares to the transferor company resident outside India, subject to the conditions that:

1. The percentage of shareholding of persons resident outside India in the transferee or new company does not exceed the sectoral cap, and
2. The transfer company or the transferee company or the new company is not engaged in activities which are prohibited under the FDI policy.

However, cash-less issue of shares on account of the merger of a foreign company with an Indian company require prior approval of the FIPB. Therefore, issue of shares by the Indian amalgamated company to the foreign shareholders of the foreign amalgamating company would require approval from the FIPB.\(^\text{83}\) Even in the case of amalgamation of two Indian companies, when the transferee company had to issue shares to the shareholders of the transferor company, the transferee company had to comply with the requirements of the FEMA and RBI Act for allotment of shares to the shareholders of the transferor companies under the scheme since foreign body corporates are the shareholders of the transferor company.\(^\text{84}\)

6.2.9. Foreign Exchange Management Act, 1999

Earlier, Foreign Exchange Regulation Act, (FERA) was applicable law in cross-border mergers and amalgamations. But it was repealed in 1999 by the Foreign Exchange Management Act, 1999. If the mergers result in a foreign entity acquiring shares in an

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\(^\text{82}\) “Consolidated FDI Policy”, Effective from 5 April 2013, retrieved from [http://dipp.nic.in/English/Policies/FDI_Circular_01_2013.pdf](http://dipp.nic.in/English/Policies/FDI_Circular_01_2013.pdf), accessed on 25 November 2013 at 6.06 pm.

\(^\text{83}\) Ernst and Young, 2012, p. 317.

\(^\text{84}\) Convansys (India) (P.) Ltd., In re (2009) 96 SCL 470 (Mad.); Also see, Geomysore Service India (P.) Ltd., In re (2009) 94 SCL 116 (Kar.).
Indian company, then provisions of the Foreign Exchange Management Act, 1999 (FEMA) read with Foreign Exchange Management (Transfer or issue of Security by a Person Resident Outside India) Regulations, 2000 becomes relevant.

Provisions of FEMA are applicable where the scheme of amalgamation or merger or takeover envisage issue of shares/cash option to Non-Resident Indians. The affected companies are required to obtain prior permission to the Reserve Bank of India under the FEMA or regulations made there under. Section 3 of FEMA prohibits dealings in foreign exchange or foreign security to any unauthorised person or make any payment to or for the credit of any person resident outside India in any manner, or receive any payment from or on behalf of any person resident outside India. The restriction covers financial transaction entered in India which may be as consideration or associated with the acquisition or creation or transfer of any asset outside India by any person. RBI is empowered to give general or special permission to any dealing in foreign exchange.\(^{85}\)

**6.2.10. Foreign Exchange Regulations**

RBI has made Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000\(^{86}\) in exercise of the powers conferred on it by section 6(3)(b) and section 47 of FEMA to prohibit, restrict or regulate, transfer or issue security by a person resident outside India. Under Regulation 7 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 (here-in-after referred to as FEMA Regulations 2000), once a scheme of merger, demerger or amalgamation has been approved by the court, the transferee company (whether the survivor or the new company) is permitted to issue shares to the shareholders of the transferor company resident outside India subject to the following conditions:

1. The percentage of non-resident holdings in the transferee or new company does not exceed the limits for which approval has been granted by the Reserve Bank of India or the Central Government or the prescribed sectoral ceiling under the Foreign Direct Investment (FDI) policy set under the FEMA regulations. If the

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\(^{86}\) These regulations were issued vide notification No. GSR 406(E), dated 3 May 2000.
new share allotment exceeds such limits, the company will have to obtain the prior approval of the Foreign Investment Promotion Board and the RBI before issuing shares to the non-residents;

2. The transferor company or the transferee or new company shall not engage in agriculture, plantation or real estate business or trading in TDRs; and

3. The transferee or the new company files a report within 30 days with the Reserve Bank giving full details of the shares held by person resident outside India in the transferor and the transferee or the new company, before and after the merger/amalgamation/reconstruction and also furnishes a confirmation that all the terms and conditions stipulated in the scheme approved by the Court have been complied with.

6.2.10.1. Transfer of Shares by a Person Resident in India to a Person Resident Outside India: Any transfer of shares, by way of sale, held by a person resident in India to a person resident outside India (including transfer of subscribes shares) in an Indian company engaged in a sector other than financial service sector (i.e. banks, non-banking financial companies and insurance), does not require a prior approval of the GOI, FIPB and RBI provided the following conditions are complied:

1. The activities of the investee company are under the automatic route under FDI policy as amended from time to time, and transfer does not attract the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997.

2. The non-resident shareholding, after the transfer, complies with sectoral limits under FDI policy.

3. The price at which the transfer takes place is an accordance with the pricing guidelines prescribed by SEBI/RBI.

6.2.10.2. Transfer of Shares by a Person Resident Outside India to a Person Resident in India: If shares are transferred from person resident outside India to a person

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resident in India in sectors other than financial services sector (such as Banks, NBFCs, Insurance, etc.), no prior approval from RBI will be required, if following conditions are satisfied:

1. The price at which the transfer takes place is in accordance with the pricing guidelines prescribed by SEBI/RBI.

2. The price of shares transferred by way of sale, by non-resident to resident shall not be more than the minimum price at which the transfer of shares can be made from a resident to a non-resident.

The above pricing restrictions on transfer of shares by person resident outside India to a person resident in India do not apply to the Foreign Venture Capital Investor (FVCI), as FVCI can sell shares held by it in Indian companies at a price that is mutually acceptable to the buyer and the seller. Prior approval of RBI will be required when transfer of shares by way of sale, by a person resident outside India to a person resident in India does not meet the conditions mentioned above (including shares of the Indian company in financial services sector).

Various other Modes of Transfer

1. In addition to sale, a person resident outside India can transfer any security to a person resident in India by way of gift.

2. A person resident outside India can transfer shares or convertible debentures of an Indian company, via a private arrangement to a person resident in India, subject to compliance with existing FDI/FEMA guidelines.

3. In addition to above, transfer of shares of an Indian company by a non-resident under buy back and/or capital reduction scheme of the company is permissible.

6.2.10.3. Transfer of Shares by a Person Resident outside India to a Person Resident Outside India:

A non-resident Indian may transfer by way of sale or gift, the shares or convertible debentures held by him or it to another non-resident Indian only. But

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90 FVCI is a Foreign Venture Capital Investor, incorporated and established outside India and registered under the SEBI (FVCI) Regulations, 2000.

91 Regulation 9(2) of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.
transfer of shares or convertible debentures from a NRI to NR would require specific approval from RBI. A foreign investor including a NRI, would be required to obtain a prior permission of Foreign Investment Promotion Board (FIPB), Secretariat for Industrial Assistance (SIA) to acquire the shares held by a non-resident in a domestic Indian entity if it has previous venture or tie-up in India through investment in shares or convertible debentures or a technical collaboration or a trade mark agreement or investment in the same field or allied field in which the Indian company whose shares are being transferred is engaged. The restriction would not be applicable to the transfer of shares to international financial institutions and transfer of shares to Indian company engaged in information technology sector.  

6.2.10.4. Responsibilities/Obligation of the Parties: All the parties involved in the transaction have the responsibility to ensure that the relevant regulations under FEMA are complied with, and consequent on transfer of shares, the relevant individual limit/sectoral caps/foreign equity participation ceilings as fixed by GOI are not breached.

6.2.11. Case Study-Fallout of the Bharti-MTN Deal

In the recent terms, with globalisation being the byword of success, cross-border mergers are looked upon as a one way solution to gaining access to foreign market and creating an image to compete with big corporates. But the attempt by Bharti enterprises to integrate with the South African giant, MTN Ltd., however, brought many lacunas in the Indian laws out of the closet. Here, we will have a look at the deal and the lacunas in the Indian laws. This deal has been specifically taken up by the researcher for case study because of the novelty in the process of carrying of the cross-border mergers as well as unheard hurdles arising out of it which raised important questions about the management of capital controls and other policies of the country.

6.2.11.1. A Look into the Larger Picture of the Deal: In recent years, mobile services have achieved a significant milestone in India, with the country having nearly 50

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93 Id., p. 364.
percent telecom density. Increasing competition, decreasing call rates and fluctuating net profit growth, however, made Bharti Airtel, the telecom arm of the company to enter into negotiations with MTN, so as to make new customers in African continent which is also regarded as immensely growing market, with tremendous potential for growth, unlike India where teleco’s growth is projected to reach a flat terrain in five years. Bharti Airtel and MTN have been two telecommunication companies that enjoy a dominant position in India and South Africa respectively. But the deal didn’t get through between these two companies, in fact it fell through twice. The primary logic which perhaps formed the basis of this deal’s failure was that these two companies were seen in their home territories as prized possessions and their respective governments were not willing to let them relinquish their national identities. Keeping this basic premise in mind, the researcher tries to dwell deep into the legal issues involved in this deal and how they were instrumental in the failure of this deal. The three primary legal issues involved in this deal were (1) Dual listing of the combined entity, (2) FDI regime in India and (3) India’s Takeover Code.

6.2.11.2. Prologue: Bharti Airtel Ltd. is an India based multinational mobile telecommunication company. It is the largest cellular service provider in India and makes up for about 23 percent of the India’s mobile market. On the other hand, MTN group is a South Africa based multinational mobile telecommunication company, operating in many African and middle eastern countries. It has presence in nearly 20 countries in Africa and Middle East. The two companies conducted exclusive negotiations twice, in just one year to create a transnational alliance which in future could lead to a full blown merger, however, both time the negotiations fell through.

In 2008, talks ended because of a last minute demand by MTN that Bharti Airtel become its subsidiary. After the above failed attempt, the two companies again tried to negotiate in 2009 which required Bharti to acquire about 36 percent of MTN equity and

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95 Telecom density in India is already at 50 percent and is projected to touch 80 percent by 2015.
97 Ibid.
98 The first round began on 5 May 2008 and the second round on 25 May 2009.
99 This was followed by an unsuccessful attempt by Reliance Communications headed by Anil Ambani to pull off a similar acquisition.
MTN to buy 25 percent of Bharti. However, the deal could not materialise mainly because of South African company’s demand for dual listing of the shares of the company, which required radical changes in foreign exchange, company and takeover norms in India.

6.2.11.3. Dual Listing and Its Implications: The legal setup of both the countries presented a unique challenge for this strategic alliance. As their respective governments were not willing that these companies should relinquish their national identities, therefore, one of the novel suggestions put forth in this alliance to overcome the national identity issue was to allow for the combined entity to be dual listed at Johannesburg and Mumbai. A dual listed company (DLC) structure engages two companies incorporated in different countries contractually agreeing to operate their business as if they were a single enterprise, while retaining their separate legal identity and existing stock exchange listings.\footnote{100} Thus, dual listing is a process by which a company would be allowed to be listed and traded on the stock exchanges of two countries.

In a conventional merger or acquisition, the merging companies become a single legal entity, with one business buying (for cash or stock) the outstanding shares of the other. However, when a dual listed company is created, the two companies continue to exist and to have separate bodies of shareholders, but they agree to share all the risks and rewards of the ownership of all their operating business in a fixed proportion, laid out in a contract called an ‘equalisation’ agreement.\footnote{101} Usually the two companies share a single board of directors and have an integrated management structure. When two companies in two countries enter into an equity alliance without an outright merger, dual listing means continued listing of the firms in both the countries. The key point to note here is that shareholders can buy and sell shares of both the companies on bourses in the two countries. In other words, if the Bharti-MTN deal would have happened with a dual listing rider, a Bharti share could be sold on the Johannesburg Stock Exchange.

\footnote{100}{Abe De Jong, “The Risk and Return of Arbitage in Dual Listed Companies”, as quoted in Esha Shekhar and Vasudha Sharma, 2011, p. 106.}

(JSE) and vice-versa. The dual listing is beneficial as it prevents companies from various forms of official approvals as the existence of each company is preserved.

So the major hurdle to deal was the dual listing as the South African Government wanted MTN to be continue to be listed at JSE, but Indian corporate laws as they stood at that date, do not allow dual listing. This is because there is no full capital account convertibility in India. India introduced full capital account convertibility first for NRIs in early 2002 and with the decisions in January 2004 it has substantially begun the process of introducing full convertibility for the benefit of foreigners. However, this process has not been completed as India is slowly moving in this direction. Moreover, the Government of India was not willing to change its policy on full convertibility of rupee at the time of the deal. Exemption could have been granted in this case but it was not thought feasible due to the RBI’s perception of the Indian rupee and the fiscal debt position. So the dual listing was totally ruled out which the South African government badly wanted in order to approve the deal. On top of that the Independent Communications Authority of South Africa also asserted that the proposed deal would require their approval and may face public hearings before such approval is granted.

6.2.11.4. FDI Regime for Telecom Sector in India: Another major hurdle for the deal was the complex FDI regime applicable to telecom sector in India. Radical changes to the FDI norms were made through Press Notes February 2009, March 2009 and April 2009 in anticipation of increased foreign investment which expanded upon and modified the various previous policies and the method of calculating direct and indirect foreign investment.

Press Note February 2009 laid down criteria as to how and when will a company will be considered to be ‘owned’ and ‘controlled’ by an Indian. It also clearly differentiated between direct and indirect investment. Press Note March 2009 further provided that for the assessment of FDI, foreign investment will now include investment by foreign

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103 Capital account convertibility is normally understood as the freedom to convert local financial assets into foreign financial assets and vice versa at market determined rates of exchange.
106 Id., p. 164.
institutional investors, non-resident Indians, American depositary receipts, global
depositary receipts, foreign currency convertible bonds, convertible preference shares
and convertible currency debentures. These were earlier regulated separately. It further
made it mandatory to procure FIPB approval where the control or ownership of an
existing Indian company is transferred by resident Indians and companies to a non-
resident entity as a consequence of a transfer of shares through a merger or
amalgamation.\textsuperscript{107}

Press Note April 2009 elucidated the new guidelines for downstream investment by
Indian companies. On an overall reading of these guidelines it became clear that the
Bharti-Airtel-MTN deal was made further complex as these new regulations changed
the definitions of important terms like company owned and controlled by Indians,
calculation of direct investment, indirect investment, downstream investment etc. It was
apparent that retaining ownership and control with Indian companies and Indian
residents was of paramount importance for the Government of India.\textsuperscript{108}

6.2.11.5. Issuance of GDR and the SEBI Takeover Code: The deal entailed the entire
equity expansion of Bharti Airtel to be in the form of GDR’s\textsuperscript{109} issued to MTN and its
shareholders. The main issue that arose was that whether the acquisition of 36 percent
GDR in Bharti Airtel by MTN and its shareholders as part of the combination
transaction would trigger open offer obligations under the SEBI Takeover Code.
Chapter III of the SEBI Takeover Code requires the acquirer to make an open public
offer of additional 20 percent in case it acquires 15 percent more than the economic
interest in an entity. But regulation 3(2) of SEBI Takeover Code 1997 exempts Global
Depository Receipts and American Depository Receipts so long they are not converted
into shares carrying voting rights.

To help the matter further, the SEBI delivered its informal guidance on 22 June 2009
and clarified that such acquisition would only trigger the disclosure requirements under

\textsuperscript{107} Id., p. 165.
\textsuperscript{108} Ibid.
\textsuperscript{109} A Global Depository Receipt is a negotiable certificate held in the bank of one country representing a
specific number of shares of a stock traded on an exchange of another country. In case of ADRs/ GDRs, the companies deposit their equity shares with a custodian, say a bank which in turn issues depository receipts to the investors. These receipts have all the rights barring voting rights.
Chapter II of the Takeover Code and not the open offer obligation. It was also clarified by the SEBI that the open offer obligation under Chapter III of the Takeover Code would be triggered only upon conversion of the GDRs into underlying equity.\[^{110}\] This informal guidance was one of the main pillars on which the deal was being structured. This informal guidance seemed to suggest that SEBI was in favour of the deal and necessary exemptions would be granted.\[^{111}\]

It was thought that the SEBI has made its stand in relation to the deal clear but the twist in the tale rendered all the assumptions incorrect. There was a complete U-turn by SEBI from its earlier position. Earlier, SEBI had announced that mandatory public offer to acquire the shares would not be required to be made by MTN on crossing the 15 percent threshold until the GDRs were converted into shares of the company. However, SEBI revised its takeover norms on 22 September 2009 by bringing ADR/GDRs with voting rights at par with domestic shares, thereby triggering the open offer requirement even in case of issuance of GDRs of the 15 percent limit under chapter III of the takeover regulations is crossed.\[^{112}\]

This new amendment virtually changed the dynamics of the deal. The options which MTN had was to issue GDR worth less than 15 percent stake in Bharti to avoid an open offer or MTN and its shareholders to be issued the originally agreed 36 percent stake but in the form of GDR without voting rights.\[^{113}\] The entire valuation of the deal was, however, affected since even if MTN would have agreed to buy GDRs without voting rights, demand of higher cash payment from Bharti had to be made.\[^{114}\] To add to this, political considerations also effected the deal putting again the earlier demands that the national character of the South African company was not to be affected, hence putting a question mark into the option of buying out GDR without voting rights.

Thus, the refusal to grant dual listing, change in FDI norms and complications arising out of the SEBI amendment led to the deal being scrapped.

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\[^{111}\] S.V. Adithya Vidyasagar, 2010, p. 166.
\[^{114}\] Esha Shekhar and Vasudha Sharma, 2011, p. 110.
6.2.11.6. Lessons from the Deal-Amendments in the Indian Laws: In the previous part, we have highlighted the reasons for the failure of the deal. The deal faced a lot of regulatory hurdles which have thrown light on the various lacunas in the Indian laws. The researcher has made the following recommendations so that in future if such a kind of deal comes up, it does not has to face such regulatory hurdles which may result in the failure of the deal. The above case-study was taken up by the researcher as it shows the continuing interface between the growing Indian economy and the existing framework of capital controls in the country. So here the researcher will highlight the various changes which are required in various company and foreign exchange laws to accommodate such prominent and complex cross-border deals.

(1) Dual Listing to be Allowed: Amendments are required in the Indian laws to enable dual listing in India. To allow for dual listing in India, key corporate laws of our country such as Companies Act 1956 as well as its successor-the new Companies Act, 2013, the Securities Contracts (Regulation) Act, Takeover Regulations and the Listing Agreement need to be amended. Another important amendment that will be required is that of introduction of full capital account convertibility. The dual listing arrangements require full capital account convertibility so that a shareholder should be able to acquire the shares on one stock exchange and sell them on another. The current convertibility rules do not allow an Indian citizen to hold shares in foreign currency. In this way, Indian companies would be shut out of overseas buyout opportunities if they are not allowed to issue them.

(2) Change in Rules for Outward Investment: Changes were brought to FDI Guidelines, through Press Notes 2, 3 and 4 which have impacted the flow of foreign investment into the country. But this deal has brought into forefront the facts that there is need to change rules for outward investments. This refers to change in rules to relax the way the Indian currency flows out of India. It would help to conduct transactions of local financial assets (like shares) into foreign financial assets freely and at prices determined by the markets.\textsuperscript{115}

\textsuperscript{115} \textit{Id.}, p. 112.
(3) **Listing in the Form of Indian Depository Receipts:** Absence of capital account convertibility should not act as a stumbling block in the way of deal. This could be done by adopting an alternative way of listing of foreign companies in the form of Indian Depository Receipts (IDRs) and not their underlying shares. Although the legal regime relating to IDRs has been in place for the last few years, no company is yet to avail of it. The regime for IDR can work as an alternative for the major changes. The listing obstacle, where lack of capital account convertibility in the erstwhile deal meant that neither MTN nor Bharti shareholders could access each other bourses while dealing with shares, could have been temporarily solved through depository receipts.\(^{116}\) Bharti Airtel could be traded in South Africa in form of depository receipts in their home currency whereas MTN could be listed through IDRs in the Indian bourses which would have facilitated quotation for MTNs shares in rupees. Perhaps, this would incidentally kick-start the comatose market for IDR’s in India.\(^{117}\)

6.2.11.7. **Final Words for the Deal:** The 23 billion US dollar deal for the merger of Bharti Airtel and MTN fell through finally on 30 September 2009.\(^{118}\) All the factors discussed above have been responsible for the deal failure. Both the companies since then have worked on their separate strategies to achieve their respective objectives. Bharti Airtel acquired 70 percent stake in Bangladesh based Warid telecom in 2010. It also acquired African assets of Zain Telecom, a Kuwait based telecom company. It does seem that both the companies have moved on from the failed deal but certainly this deal’s exceptional potential because of the market penetration opportunities available in the African markets and the low cost model running experience of Bharti Airtel cannot be ignored.\(^{119}\) This deal should act as an eye opener for the Indian policy makers because the current state of globalisation makes it imperative that this deal would not remain a one off incident.\(^{120}\) Hence, need of the hour is to make necessary

\(^{116}\) Ibid.


\(^{118}\) S.V. Aditiya Vidyasagar, 2010, p. 166.

\(^{119}\) Id., p. 167.

\(^{120}\) Esha Shekhar and Vasudha Sharma, 2011, p. 113.
changes in the law and regulatory procedures so that such a situation does not arise in future. Thus, the need of the hour is prevent such a situation to rise again and prevent companies from trying back door entries when a legally regulated front-door entry is possible.

6.3. Intellectual Property Issues in Mergers and Acquisitions

Intellectual property (IP) is fast becoming the biggest incentive for mergers and acquisitions. The driving force behind a majority of mergers completed during the past decade has been the acquirer’s desire to obtain the target’s intellectual property assets. The importance of intangible assets has created an urgent need to value these assets in many contexts including, intellectual property management, mergers and acquisitions, sales, corporate takeovers, joint ventures and licensing. In case of mergers and acquisitions, valuation of intangible assets helps to determine the value of the target company for the buyer.

Today, some two thirds of the value of America’s large businesses can be traced to intangible assets, such as patents, trademarks and copyrights. Issues pertaining to merger and acquisition activity are not simply relegated to large, multinational corporations. Small and medium size businesses can add significant value and revenue by exploiting the full potential of their valuable intangible rights. Moreover, intellectual property rights have enabled small or medium size businesses to achieve large entity status and enormous capital values in relatively few years, such as Microsoft and Sun Microsystems. That’s why, in the context of increasing importance of intellectual property, valuation, audit and due diligence the process of confirming and investigating the status of Intellectual Property Assets has become increasingly important in M&A deals.

124 Amit Kumar and Arvind Giriraj, 2010, p. 82.
6.3.1. Meaning of the Term ‘Intellectual Property’

First of all, let’s understand the meaning of the term ‘intellectual property’. Intellectual property can be loosely defined as a creation of the human mind. It could be incorporated in creative or inventive works, including distinctive signs or marks. Example are books, paintings or other literary and artistic works, inventions, designs etc. Intellectual Property Rights (IPRs) are legal rights governing the use of such creations.\(^{126}\) It is information and original expression which derives its intrinsic value from creative ideas.\(^{127}\) It is the information with commercial value.\(^{128}\) In law, particularly, common law jurisdiction intellectual property refers to a legal entitlement which sometimes attaches to the expressed form of an idea or of other intangible subject matter.\(^{129}\) The World Intellectual Property Organisation defines ‘intellectual property’ as being ‘creations of the mind: inventions, literary and artistic works and symbols, names, images and designs used in commerce’ and divides it into industrial property (patents, trademarks, industrial designs etc.) and copyrights (in literary and artistic works, etc.).\(^{130}\) The most well known form of intellectual property assets are patents, trademarks, copyrights, know-how, trade secrets etc. Most recently included in this category and of ever-increasing importance are mask-works and internet domain names.

To sum up in simple words, most creations resulting from human endeavors in various fields of art, literature, science and technology constitute intellectual property.

In an increasing fashion, the value and importance of intangible assets are the driving force behind national and international mergers and are playing a greater role than ever before in terms of assets received through mergers, acquisition and takeovers. In the event of a merger or other type of corporate restructuring, the acquiring party should

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\(^{130}\) Quoted in, Amit Kumar and Arvind Giriraj, 2010, p. 81.
obtain equitable and record ownership of these intangible assets or at the very least, acquire the appropriate license to use such intellectual property.\textsuperscript{131}

6.3.2. Importance of Intellectual Property as a Business Asset in Mergers and Acquisitions

In earlier times, the concept of property meant something tangible. As time went by, property created by the scope of one’s intellect became what is known as intellectual property.\textsuperscript{132} It is worth noting that intellectual capital has become critical to the industry and its growth. Successful multinational companies give tremendous value to their intellectual property. The value of intangible capital of General Electric is estimated at 324 billion dollars. In the information technology sector, IBM and Verizon are estimated to have intangible capital of 134 billion and 105 billion dollars respectively.\textsuperscript{133} Intellectual property is often the corporation’s biggest asset. Indeed, in the ‘new economy’ brand names—that is trademarks, service marks and patents—are often as important as the goods and services in connection with which they are used in creating a competitive advantage. Sounds, smells, colours and product shape can all enjoy trademark protection. The patents which embody the inventions incorporated in a company’s products are also critical in protecting the patents holder rights to exclude others from marketing a particular product.\textsuperscript{134} For example in 2012, Apple won a major patent litigation against Samsung as Samsung had infringed on Apple’s intellectual property and had to pay at least $119.6 million in damages to Apple. The Samsung was found guilty by the jury for infringing Apple’s utility patents as well as the design patent (iphone’s array of icons across the board). The jury found that some Samsung smartphones and tablets violates Apple’s patents.

Smith and Parr have calculated the following percentages of intangible assets for the following companies: Johnson and Johnson (87.9 percent) Protor and Gamble (88.5


\textsuperscript{133} Tabrez Ahmad, “R&D and Intellectual Property Rights in Information and Communication Technology Industry of India”, retrieved from www.ficii.com accessed on 15 May 2008 at 4.10 pm.

percent), Merck (93.5 percent), Microsoft (97.8 percent) and Yahoo (98.9 percent).\textsuperscript{135} The intellectual property of Gillette is 76.3 percent.\textsuperscript{136} All these facts clearly demonstrate the immense value and critical nature of intangible assets for effective participation in the evolving knowledge economy.\textsuperscript{137} It should come as no surprise that intellectual property often plays an important role in the sale or purchase of a business.

In mergers and acquisitions, value of business to be acquired is usually in excess of tangible asset value and a major part of this excess is intellectual property. As, when Rowntree, the UK chocolate manufacturer was acquired by the Swiss Confectionery and food giant Nestle at a price more than double the market value, it was due to the intellectual property rights of Rowntree. Such is their importance that they can double the value of a business.

Thus the importance of intangible assets has created an urgent need to value these assets in many contexts including intellectual property management, mergers and acquisitions, sales, corporate takeovers, joint ventures and licensing. In the context of acquisitions, sales and joint ventures, intangible assets valuation is necessary to determine the value of a company to a buyer or seller and the value of partners’ contributions to collaborative undertakings.\textsuperscript{138}

\textbf{6.3.3. Need of Intellectual Property Valuation in Mergers and Acquisitions}

Valuation of Intellectual Property results in:

\textbf{(1) Intangible Benefits:} Financial valuation of intellectual property will result in following intangible benefits:\textsuperscript{139}

\begin{enumerate}
\item Enhanced confidence
\item Indicator of Effective Utilisation
\item Credibility to the real worth
\end{enumerate}

\textsuperscript{138} Tahir Ashraf Siddique, 2011, p. 31.
(2) **Tangible Benefits:** A balance sheet which incorporates proper valuation of intellectual property rights provides a more realistic, presentation of company’s financial position. Intellectual property valuation helps in arriving at the correct and accurate price and evaluating the real worth of the target company in a M&A deal. The valuation report of Intellectual Property also shows as to how the value has been worked out elaborating all assumptions which provides the real insight and is of great value to the acquirer.

Moreover, changes in the global economic environment have influenced the development of business models where Intellectual Property (IP) is a central element establishing value and potential growth. In addition to these systematic changes in international mergers and acquisitions, international accounting practices place pressure on firms to recognise and value all identifiable intangible assets of a firm as part of a transaction.\(^\text{140}\)

Intellectual property rights (patents, trademarks, designs and models, copyrights software, trade secrets etc.) are now very crucial and critical for a business, whether recently formed or already mature, whether it is a multinational enterprise or a small venture. In mergers, demergers, spin-offs, acquisitions etc, it is no longer possible to ignore the importance of the intellectual property rights because ignoring their specific value may produce extremely detrimental results. Valuations made in respect of these assets have become more frequent since certain prominent companies have started publishing, in their annual reports, the results of valuation of intellectual property rights (e.g. IBM, TMM etc.).

**6.3.4. Difference in Valuation Techniques of Tangible and Intangible Assets**

There lies an inherent difference in the valuation of tangibles and intangible assets. First, the public trading markets that exist for financial and physical assets do no exist for intellectual property assets. Although exchanges of intellectual property assets occur every day in every industry, yet these, exchanges are sporadic and specialized, motivated by strategic advantages unique to the firms involved. Second, the terms and

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conditions of intellectual property transfers vary widely. Lawyers and licensing professionals negotiate and craft agreements to suit the special needs of their clients, and rarely are the two agreements identical. Third, intellectual property assets are inherently dissimilar, and the dissimilarity is sometimes required by law.\textsuperscript{141} Fourth, and most important, the details of intellectual property transfers are rarely made available to the public. Again, the principal motivation for intellectual property asset exchange is strategic advantage, and firms will not publicise exchange details, which could reveal strategic objectives.\textsuperscript{142}

6.3.5. Various Approaches to the Financial Valuation of Intellectual Property Rights

Valuation of Intellectual Property assets remains the trickiest part. Risks, timing, cost, future cash flows, competition, equilibrium price etc. of Intellectual Property assets form the pillars on which the valuation may be based. At the same time, an ever-changing landscape of tax, financial and regulatory requirements impose differing and ambiguous standards for valuing Intellectual Property. The various approaches to valuation of intellectual property rights are:

(1) The Cost-Based Approach: The general principle governing the cost approach is the principle of substitution which states that one would not pay more for the property than the cost to create it. This approach seeks to define value by starting from the principle that an investor will not pay more for any given investments than for another investment producing the same level of usefulness or functionality.\textsuperscript{143} The cost approach is very useful as valuation method for intellectual property such as computer software and research & development programme.\textsuperscript{144}

(2) The Market based Approach: This approach is based on the principles of competition and price equilibrium. This approach seeks to define value by starting from the principle that, in a free market, supply and demand will lead the price of any asset to its equilibrium point. The identification and analysis of the equilibrium prices of

\textsuperscript{141} Tahir Ashraf Siddiqui, 2011, p. 35.
\textsuperscript{142} Ibid.
substitutable assets will provide an empirical confirmation of the valued assets value.\textsuperscript{145} Another method of market approach is to arrive at value by comparing the price at which similar intellectual property has been exchanged between willing buyer and seller.\textsuperscript{146} In this method, market based valuation looks at comparable market transactions whether sale or purchase of similar assets to arrive at conclusions of value.

(3) \textbf{The Income based Approach:} This approach which is based on economic principle of anticipation seeks to define the value of an asset by measuring the present value of future economic flows generated by the possession of the asset,\textsuperscript{147} i.e. future stream of economic benefits that can be derived from the commercialisation of the intellectual property assets. The investor basis his expectation on the revenues anticipated from the asset.

Now the question arises as to how these methods are used or implemented during the corporate transactions involved in mergers and acquisitions. It is a pragmatic step wise methodical procedure.

\textbf{6.3.6. Risk Assessment}

One of the essential steps of these methods consists in taking into account the legal risks likely to affect the economic potential of an Intellectual Property asset. The quantification of these risks leads to an objective and relevant weighing of the financial analyses’ results. Ignoring these risks would lead to an overvaluation of the assets. This might prove extremely damaging as was shown when the latest financial bubble bursted. The nature of these risks wholly depends on the intangible nature of the valued rights. This is why these risks may only be assessed by specialists.\textsuperscript{148}

Valuing a patent, without considering its legal and technical aspects, which may alone provide the basis for a fair value assessment of the intrinsic contents of the relevant asset and its security, will lead to catastrophic errors. It is also, for this same reason, that intellectual property rights are often overvalued.\textsuperscript{149}


\textsuperscript{147} Amit Kumar and Arvind Giriraj 2010, p. 83.

\textsuperscript{148} \textit{Id.}, pp. 83-84.

\textsuperscript{149} \textit{Ibid.}
Valuing a software, without considering the risks associated with its protection, leads to the same consequences. It is essential to introduce the protection criteria in the financial valuation, because the valuation always covers a monopoly. Any risk threatening such monopoly unavoidably reduces the economic value of the rights.

Valuing a brand without considering the legal risks (validity, scope, priority and freedom to use) may lead to an investment that will never generate any return because economic data and results specifically depend on the intellectual property rights’ validity and security.

**6.3.7. Intellectual Property Due Diligence in Mergers and Acquisitions**

A due diligence is an investigation or audit of a potential investment or entity with a certain level of care so as to ascertain its viability-commercial, financial, taxation and legal. It is a way of preventing unnecessary hassles to either party involved in a transaction.\(^\text{150}\) Due diligence of intellectual property assets is assessment and consideration of the intellectual property assets of a business. IP due diligence is the process of investigating a party’s ownership, right to use, and right to stop others from using the IP rights involved in merger-the nature of transaction and the rights being acquired will determine the extent and focus of the due diligence review. The increased profile, frequency, and value of intellectual property related transactions have elevated the need for all legal and financial professionals and IP owners to have thorough understanding of the assessment and the valuation of these assets, and their role in commercial transactions. Intellectual property due diligence generally provides vital information specific to future benefits, economic life and ownership rights and the limitations of the assets all of which affect final value.\(^\text{151}\) Therefore due diligence is prerequisite to the valuation process, regardless of the methodology used. Often early attention to the due diligence of the intellectual property aspects of a transaction can actually result in the conclusion that the proposed transaction should be structured in a particular way or reconsidered. If a buyer fails to exercise due-diligence in buying of

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\(^{151}\) Karnika Seth, “Intellectual Property Due Diligence in Mergers and Acquisitions”, retrieved from [www.sethassociates.com/wp-context/uploads/%20properly%20due%diligencee](http://www.sethassociates.com/wp-context/uploads/%20properly%20due%diligencee), accessed on 4 March 2012 at 1.00 pm.
intellectual property, it may result in disastrous results for it. Conversely, the seller will want to maximise the terms of the deal by demonstrating the high value of their company’s intellectual property assets and the unlikelihood of any infringement. Therefore, both parties to the sale of a business must perform similar due diligence not only on the intellectual property rights of a business at issue itself, but also on those rights of the business’s main competitors in the marketplace.152

The process of IP due diligence in M&A’s reveals the following aspects:

- The owners of the rights.
- The validity, transferability and enforceability of the rights.
- Any agreement or restriction that prevents the party from granting rights to another.
- The registration of intellectual property.
- Past or potential litigation.
- Unenforceability of intellectual property rights due to misuse of IP assets.
- Any encumbrances on intellectual property rights.
- Evaluating agreement material to the company’s business that may be affected by change of control and that transfer rights in intellectual property assets.

Although the prospects of conducting a due diligence may seem daunting, the procedure is extremely useful and can yield very profitable results for the purchaser. The need and importance of IP due diligence in M&A activity cannot be overstated. The Volkswagen story is an excellent example of the same.

Volkswagen’s 1998 acquisition of Rolls Royce provides an excellent rationale for doing Intellectual Property Due Diligence (IPDD) and for doing it early. Volkswagen bought Rolls-Royce Motor Cars, the company that makes both the Rolls and the Bentley, from Vickers, but apparently forgot to do the IPDD. Volkswagen paid more than US $700 million for the designs and manufacturing facilities, but when the deal was said and

done, Volkswagen could not use the famous Rolls-Royce name on its new luxury cars. Instead, BMW bought the Rolls-Royce trademarks from the actual owner, Rolls-Royce PLC, the aircraft company, for a mere US$65 million, and eventually BMW ended up making the famous car, instead of Volkswagen. The moral of the Volkswagen story is that, even thought IP is critical to many deals, the IPDD often receives scant or hasty attention and the omission can be costly. It’s far better to perform the diligence early enough in the negotiations to be able to use any identified problems in the target company IP assets and to be able to negotiate a lower price.\footnote{Tahir Ashraf Siddique, 2011, p. 30.} A detailed investigation into a business’s intellectual property from the beginning of an M&A transaction is critical as many transactions like Volkswagen (mentioned above) are adversely affected by a failure to consider and address intellectual property issues from the outset.

To, further authenticate our point, we shall take a hypothetical situation. A corporate acquisition happens, which is worth billion dollars, primarily for the purpose of acquiring a well-known trademark. As generally happens, many weeks are required to negotiate and draft the various instruments through which the transaction will materialise. The acquiring company also conducts general due diligence of the target company. But none of this is focused towards the trademark. The acquisition is completed but afterwards, it comes to light that the acquired company was not the owner of the trademark, rather it was licensed from the third party and the very last thing on that third party’s agenda is granting the acquirer a royalty free exclusive license to make the desired use of the system.

This situation clearly highlights the dangers that may await those who engage in transactions significantly impacted by intellectual property without taking the time or effort to undertake due diligence into that intellectual property. A lack of IP rights that are necessary for operation of the business can be a critical deficiency. Even before the latest spate of internet and ‘dot com’ driven transactions, IP had clearly come to the for as one of the prime reasons why companies sought to acquire or merge with other companies.\footnote{“When Deals Involve Intellectual Property: Due Diligence into IP Rights is Essential”, retrieved from http://www.whitecase.com/publications/detail.aspx?publication=224, accessed on 3 October 2012 at 1.00 pm.} As a result of above factors and the increasing value of intellectual
property assets in today’s high technology society, intellectual property matters have become an important aspect of a traditional due diligence study. Due diligence involves asking questions, interviewing people with knowledge about relevant matters, obtaining and reviewing relevant documents, and obtaining information from independent sources.\textsuperscript{155}

Each intellectual property due diligence investigation should be tailored to fit the specific transaction. Sometimes extensive intellectual property due diligence is not possible because of time constraints or the need to maintain the secrecy of the proposed transaction. If extensive IP due diligence is not possible, the crafting of the sellers representations and warranties in the purchase agreements becomes more critical.\textsuperscript{156} No doubt, part of the problem that emanates from a deficiency in IP rights may be cured by obtaining good warranties and representations. But in some instance, the potential deficiency may be so enormous that the warrantor may not be able to remedy its breach. In addition, in some mergers and acquisitions, there is no surviving entity to stand behind a meaningful warranty and won’t you agree that it is generally preferable to cure the problem before it occurs, then to be forced into reliance on the warranty after the fact.\textsuperscript{157} Accordingly, it becomes necessary for those who undertake M&As to conduct meaningful IP due diligence in an increasing percentage of transactions.

(1) Understanding the Nature of the Transaction and Business: It is critical to assess the nature of the business and potential transaction as only by understanding the strategic business objectives of the company, the due diligence team can direct its efforts to identify those issues that may be material to the transaction and work to resolve those issues in a manner that help the company attain its business goals.

The nature of the transaction and the companies involved affects the amount of intellectual property due diligence that is appropriate under the circumstances. For


example, a start-up computer software company will typically require more emphasis on intellectual property than a manufacturer of a well established commodity.\textsuperscript{158}

(2)\textbf{ Ownership and Sufficiency:} An important aspect of the due diligence process is confirming that the target company owns or has valid licenses for all intellectual property and technology that is used in the target company’s business. This is done by reviewing documents relating to ownership of registered intellectual property and the agreements with third parties pursuant to which the target company is granted the right to use such third parties intellectual property or technology.\textsuperscript{159} If a business does not aggressively monitor, protect and maintain intellectual property rights, it may be acquired by a third party intellectual property owner to pay license fees or be forced into expensive and time consuming litigation over disputed intellectual property rights.

(3)\textbf{ Infringement Issues:} The issue of infringement should also be addressed. The target company should fully disclose potential infringement issues to the purchasing entity whether they have been resolved or are pending. Infringement issue can arise in two ways: the first is infringement by the target company of the third party intellectual property rights. This type of infringement needs to be disclosed as IP infringement litigation particularly patent infringement litigation is very expensive and can take many years to resolve.\textsuperscript{160}

(4)\textbf{ Intellectual Property Agreements:} Intellectual property agreement can present a number of significant issues, and therefore should be reviewed carefully as part of the due diligence process. For agreements pursuant to which the target company receives a license to use a third party’s intellectual property or technology, the acquiring company should confirm that the scope of the license is broad enough to cover all current and anticipated future uses of the licensed intellectual property or technology (including the right to make modification, if applicable), contains reasonable indemnification provisions (ideally with those obligations excluded from any limitations on the licensor’s potential liability), and contains ownership provisions allocating ownership of


\textsuperscript{160} Ibid.
any permitted modification. This will ascertain whether the company’s licenses are of sufficient breadth to cover future use or modification of the technology and ownership indications for improvements.

(5) **Confirmation of Company’s Right to Use:** In addition to determining what intellectual property assets are held by the business itself, it is also important to explore the ‘right-to-use’ question. While it is important that a business develop a position of strength for its products and services, it is not always guaranteed that a holder of a patent has the right to make, use or sell its own patented product or service. A competitor may be quietly pursuing patents, trademarks or copyrights on products or services that are under parallel development by all businesses in a market niche. The unfettered right to use, make or sell certain technology, or to use trademarks or material subject to copyrights, is often crucial to the health of any business. So before acquiring a company, make sure that the target possesses the right to use the technology.

(6) **Employee’s Issues:** In the absence of a contract, ownership of inventions (whether or not patentable) initially vests in the inventor. Therefore, the acquiring company should confirm that all of the target company’s employees and contractors have executed written agreements assigning ownership of all intellectual property and technology developed by those parties to the target company. In certain limited circumstances, a license from the employee or contractor to the target company may be sufficient, though those cases should be carefully reviewed prior to a determination of sufficiency.

(7) **Background Searches:** Some businesses regularly undertake background searches and investigations of their intellectual property rights. The fact that a business periodically conduct such searches will not only add to its value, the level of due diligence required to close the deal on the behalf of acquirer will be greatly reduced.

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To sum up, we can say that a detailed investigation into a business’s intellectual property from the beginning of an M&A transaction is of utmost importance. Many transactions are adversely affected by a failure to consider and address intellectual property issues from the outset.\textsuperscript{164} A due diligence study of IP rights before M&A provides critical information on the ownership of these assets, ensuring that those assets are valid and free from any defects or encumbrances and can be validly transferred by the target company. It enables the buyer to make an informed decision about the potential transaction and removal of any weaknesses so that the transaction can lead to fulfillment of the client’s ultimate business goals. The above-mentioned due diligence issues become more complex and multifarious in cross-border mergers and acquisitions. Therefore, due care should be taken in cross-border M&As.

6.3.8. Due Diligence of Intellectual Property Assets in Mergers and Acquisitions with Respect to Indian Laws

In this era of mergers, acquisitions and reconstruction of corporate entities, the management, protection and preservation of Intellectual Property Rights related with patents, trademarks, copyrights and industrial designs have acquired enormous significance. This has become relevant for Indian Business and Industry. In an increasing fashion value and importance of Intellectual Property Rights are the driving force behind national and international mergers in India.\textsuperscript{165}

It is a common experience, that companies and corporate entities do not give much importance to the portfolio management of their Intellectual Property Rights. It has been seen that even change of one principal officer of a company, puts its entire Intellectual Property Rights in a chaotic situation. Files, certificates, applications and up to date information may not be traceable and organised, and when some body some day digs out these files, it is found that precious Intellectual Property Rights have been lost due to failure to renew or non-prosecution of applications or proceedings.\textsuperscript{166}

\textsuperscript{164} Tahir Ashraf Siddique, 2011, p. 37.
\textsuperscript{166} Ibid.
In the above scenario of due diligence and audit of Intellectual Property Rights, before M&As, acquire great significance and particularly when there is merger and acquisition of companies, also resulting in transfer and realignment of Intellectual Property of these companies in India. While conducting due diligence of IP, it is imperative to find out the status of various Intellectual Property Rights like patents, trademarks, copyright, industrial design etc held by a company.

6.3.8.1. Patents: As compared to other types of intellectual property, patents are among the most valuable, costly and difficult to obtain. A patent is defined by the US Patent and Trademark Office as “the grant of a property right to the inventor, providing the owner the right to exclude others from making, using, offering for sale, selling, or importing the invention.” As is evident from the above definition, an issued patent is not a right to use a patented invention. An issued patent allows the patentee to prevent others from using the patented process or practicing the patented method. Any apparatus, composition of matter, product, methods or improvements in methods can be patented. Patents are one of the most significant IPRs possessed by a business and their value has now been realised at the global level. Superiority and prosperity of USA in all squares of technological and industrial area can be attributed to its strong and vibrant patent regime.

In a merger or acquisition transaction, the acquiring company must check the assignment records of the Controller of Patents or the Appropriate Foreign Patent Office in case of cross-border mergers and acquisitions. The following points should be taken note of while conducting due diligence of patents.

As already discussed, a patent gives its owner the right to exclude others from practicing the invention. Accordingly, the fact that the target company has patented its product is not an indicator that it is free to make and sell that product. The prudent acquirer may undertake a ‘right to use’ study, wherein a search is made for extant

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patents that might impact the most important new products (or services) of the target company. However, even a thorough right to use study cannot guarantee freedom from patent problems, because the patent offices are required to maintain patent applications in secrecy generally (at least for initial 12 to 18 months), and there is in general no way to acquire information about these patent applications.¹⁶⁹

Still, if the seller’s patents are important to its business and are used to enforce the seller’s rights against its competitors, the seller’s patents and patent applications should be carefully reviewed by the buyer’s patent attorneys to evaluate their strength. Although an issued patent is presumed to be valid, many patents are found to be invalid, when challenged and defending a suit challenging the validity of the patent can be very expensive.¹⁷⁰ Patent applications are filed in the name of the inventor. If an assignment from the inventor to the seller is not recorded with Controller of Patents, the inventor is presumed to be the owner. To avoid ownership issues, the buyer should ensure that all assignments have been obtained and that all of the seller’s employees promptly execute invention assignment agreements.¹⁷¹ The transferee company is required to apply to the Controller of Patents in writing for the registration of patents in its name.

In addition to above points, the acquirer company must also note that if alternate products can compete effectively with the patented technology without infringing the patents, then the patents might have relatively little value even though they cover a large area.¹⁷² These due diligence studies must be conducted as regards the patents of the target company so that we can correctly value them as well as the target company in a M&A transaction.

6.3.8.1.1. Transfer of Patent Rights in India: A patent is recognised as a species of property and can be transferred from the original patentee to any other person.¹⁷³ A patent can be transferred from the original patentee to any other person by assignment


¹⁷¹ Ibid.

¹⁷² Edward A. Meilman and James W. Brady, 2003, p. 21.

or by grant of license in a merger or acquisition transaction. Assignment means the transfer by a party of all of its rights or interest in the property.\textsuperscript{174} A licence is a permission to make, use or exercise the patented invention which would otherwise be illegal to do so. In licence, the ownership of patent remains with patentee, mere partial use is permitted.\textsuperscript{175} Therefore, acquiring company should see that it gets the assignment of IPR’s as compared to licence. That’s why, its rightly said that in the event of merger or acquisition, the acquiring party should obtain equitable and record ownership of patents or at the very least, acquire the appropriate licence to use such patents. The rules for transfer of assignment or licence in patents are governed by the sections 68-70 of Patent Act, 1970. These sections say that:

1. The transfer, assignment, mortgage or licence should be reduced in writing in a document, embodying all the terms and conditions governing the rights and obligation between the parties.\textsuperscript{176}

2. The written agreement is duly registered under the provisions of the Indian Patent Act.\textsuperscript{177}

In \textit{National Research Development Corporation of India, New Delhi v. Delhi Cloths and General Mills Co. Ltd.},\textsuperscript{178} it was reiterated by Delhi High Court that the assignment of a patent shall be valid only if the assignment is in writing and the agreement of assigning is reduced to the form of a document which embodies all the terms and conditions governing the rights and obligations of the parties, and the application for registration of such deed of assignment is filed with the Controller within six months of the execution of such document.

Lastly, the acquirer should also take care of the fact that whether a patent is owned individually or jointly by the seller because if the seller is co-owner, he alone cannot assign his share of patent or grant license without consent of the other co-owners. If he


\textsuperscript{175} \textit{Id.}, p. 115.

\textsuperscript{176} Section 68 of the Patents Act, 1970.

\textsuperscript{177} Sections 69 and 70 of the Patents Act, 1970.

\textsuperscript{178} AIR 1980 Del. 132.
does so, such assignment or license will not be valid in the eyes of law, due to which buyer will not be able to realise synergies in merger.

6.3.8.2. Trademarks: Trademark is another critical area for Intellectual Property Due Diligence in M&As. A trademark is a visual symbol in the form of a word, device or a label applied to articles of commerce with a view to indicate to the purchasing public that they are the goods manufactured or otherwise dealt by a particular person as distinguished from similar goods manufactured or dealt by other persons.\textsuperscript{179} In other words, a trademark is a visual representation attached to goods for the purpose of indicating their trade origin. For example, the trademark ‘Lakme’ distinguish the goods of Lakme Lever Company from those of ‘Loreal’ or ‘Revlon’. Thus, trademark is a kind of property and is entitled to protection under law.\textsuperscript{180} Even the section 2(1)(zb) of the Trademarks Act, 1999 defines ‘Trademark’ as a mark capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of others and may include shape of goods, their packaging and combination of colours.

The due diligence of rights related with trademark are more difficult than patents. A company may possess registered as well as unregistered trademarks. The registration offers prima facie evidence of ownership of trademark whereas in case of unregistered trademarks one has to establish prior use and is protectable under common law principles by a passing off action only. Thus, a company with registered trademarks will become a more attractive destination for the prospective buyer because the law accords protection to the exclusive right of the registered proprietor to exploit the trademark.

In contrast to it, the unregistered proprietor of a trademark cannot have this right, instead he can bring a suit for action against any person for passing off goods or services.\textsuperscript{181} In addition to above points, in a due diligence process identify those trademarks of the company that may have been abandoned.

\textsuperscript{180} \textit{London Rubber Co. Ltd. v. Durex Products} AIR 1959 Cal. 56.
6.3.8.2.1. Assignability and Transmissibility: Being a species of property, a right in a trademark is transferable as any other right in property. Thus, a trademarks, like any other form of intellectual property, is also capable of being transferred. Irrespective of any other law to the contrary, a trademark is assignable and transmissible subject to provision of section 37-45 of Trade Marks Act, 1999. Section 37 of the Trade Marks Act, 1999 empowers the registered proprietor to assign the trade mark and to give effectual receipts for any consideration for such assignment. However, it should be made clear that mere permission to use trademark will not amount to assignment of trademark.182 A registered trade mark is assignable and transmissible whether with or without goodwill of the business concerned. This is so with an unregistered trademark as well.183 The assignment can be for all of the goods or services covered by such trademark or only some of such goods or services.184 The assignment of trademark must be in writing and specify the condition and limitations to which the assignment is subject to.185

6.3.8.2.2. Restriction on Assignment: A trademark can be transferred or assigned in India but it is subject to restrictions imposed under section 40 and 41 of the Trade Mark Act, 1999. For example, a trade mark shall not be assignable or transmissible in a case in which as a result of the assignment or transmission there would be in the circumstances subsist, whether under this Act or any other law, exclusive rights in more than one of the persons concerned to the use, in relation to:

(a) Same goods or services;
(b) Same description of goods or services;
(c) Goods or services or description of goods or services which are associated with each other,

Of trademarks nearly resembling each other or of identical trademarks, if having regard to the similarity of goods and services and to the similarity of the trade marks, the use of the trademarks in exercise of those rights would likely to deceive or cause confusion.186

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182 Ramappa v. Monappa AIR 1970 Mad. 156.
186 Section 40(1) of the Trade Marks Act, 1999.
6.3.8.2.3. **Registration of Assignment:** Registration of assignment with Registrar is necessary. The buyer in whose favour assignment is made will make an application to the Registrar for registration of assignment. The Registrar shall, on receipt of application and on proof of title to his satisfaction, register the person as a proprietor of trademark in respect of goods or services in respect of which assignment has been effected.

In *Ratansi Mulsi v. Vinod Ratilal Gandhi*,\(^{187}\) the Bombay High Court has held that it is abundantly clear that without registration of the assignment or transmission, no rights can be pleaded on the ground that trade mark has been assigned or transmitted. But the Supreme Court has abundantly clarified the position in case of *CCE v. Vikshara Trading and Investment (P.) Ltd.*,\(^{188}\) the Supreme Court has held that in case of non-registration of assignment of a registered trade mark, if on facts it is amply proved that assignment has taken place, mere non-registration of assignment will not vitiate the effect of assignment. But still, the researcher is of the view, in M&A transaction, the acquirer company should prefer registration of trademark in its name to avoid any confusion and legal hassles.

6.3.8.3. **Copyrights:** The right which a person acquires in a work, which is the result of his intellectual labour, is called his copyright.\(^{189}\) As literary and artistic creation is a unique feature of human being, this intellectual creativity need to be recognised and protected by law. Therefore, concept of copyright law originated whose primary function is to protect the fruits of a man’s work, labour, skill or test from being taken away by other people.\(^{190}\) The statutory definition of copyright according to the Sec 14 of the Copyright. Act, 1957 is as follows: Copyright means the exclusive rights to do or authorize others to do certain acts in relation to:

(a) Literary, dramatic or musical works

(b) Computer programme

(c) Artistic work

\(^{187}\) AIR 1991 Bom 40.

\(^{188}\) (2004) 13 SCC 49.

\(^{189}\) B.L. Wadehra, 2007, p. 263.

\(^{190}\) *Ibid.*
(d) Cinematograph film

(e) Sound recording

The determination of the status of copyrights owned, registered and possessed by the company, is of high importance, without which no due diligence is complete. It should be found that how many registered as well as unregistered copyrights are possessed by the company, and whether these copyright have been properly assigned in favour of the company.\footnote{Vijay Pal Dalmia, 2006, p. 4.} Another important aspect to be noted is that ordinarily copyright ownership vests in the author of the work. An exception to this rule arises in ‘works made for hire’, which are works either prepared by an employee within the scope of his employment or works specially ordered as ‘works made for hire’. In these cases ownership rights vest in the employer.\footnote{Louis R. Dienes and Troy Gould PC, “Intellectual Property Issues in Mergers and Acquisitions”, Bloomberg Law Reports-Mergers and Acquisitions, Vol. 4, No. 21, retrieved from http://www.bloom berglawreports.com, accessed on 4 October 2012 at 1.52 pm.} But the person developing the work owns the copyright if he or she is a consultant or other non-employee, or if he or she develops it outside the scope of employment.\footnote{“When Deals Involve Intellectual Property: Due Diligence into IP Rights is Essential”, retrieved from http://www.whitecase.com/publications/detail.aspx?publication=224, accessed on 3 October 2012 at 1.00 pm.} In these cases, most of the time it is found that the companies legally do not possess the copyright. The buyers need to be particularly cautious when the seller has hired independent contractors to develop copyrighted works.

To further illustrate, if a software has been made by a developer for the company or the logo has been designed by the ad agency for the company, the copyright remains with the software developer or the artist or the slogan writer.\footnote{Vijay Pal Dalmia, 2006, p. 4.} Therefore, a buyer should ascertain that company possess the written permissions, assignments and no objection certificates from the authors and artists. If the consultant or artist does not execute an appropriate assignment he or she may be in a position to assert ownership of the resulting copyright.

\textbf{6.3.8.3.1. Assignment and Transfer of Copyrights:} In a merger or acquisition, the copyright possessed by the transferor company be transferred to the transferee company either through assignment or through licence.
(1) **Assignment of Copyright:** The effect of assignment of rights is that the assignee becomes entitled to all rights related to copyright of the assigned work. But assignment is valid only when it is in writing signed by the assignor or by his duly authorised agent. If the period of assignment is not stated, the period shall be deemed to be five years from the date of assignment and if the territorial extent of any assignment of the rights is not specified, it shall be presumed to extend within whole of India. If the assignee does not exercise the rights assigned to him within one year from the date of assignment, the assignment in respect of such rights shall be deemed to have lapsed after the expiry of the said period unless otherwise specified in the assignment instrument.

(2) **Licensing of Copyright:** In licence, the owner gives permission to do something in respect of the act in which he has an exclusive right to do, but the ownership remains with the owner. In a merger or acquisition, the buyer should ensure that it atleast gets the licence of the copyright owned by the seller. The provisions of section 19 and 19-A governing mode of granting assignment will apply to licence also.

### 6.3.8.4. Industrial Designs:
A design gives aesthetic sense and appearance to the product. To attract customers, the manufacturers gives much attention to the design of the products. The creative originality of a design needs legal protection against copying. Therefore, the Designs Act, 2000 provides for registration of original design and prohibit its copy by others. For industrial design, it is necessary to ascertain in the course of the due diligence, whether designs are registered or not and if renewal has become due, whether these registrations have been renewed or not. The registration of design will provide its proprietor the exclusive use of the design and can be enforced through courts whereas an unregistered design can be easily copied by others.

### 6.3.8.5. Trade Secrets:
A trade secret, by definition, is proprietary or business-related information that a company or individual uses or to which they posseso exclusive rights. To be deemed a trade secret, the information must meet several requirements, it must be
genuine and provides the owner with competitive advantage and is reasonably protected against disclosure. Examples of trade secrets are the recipes (e.g., Coca-Cola recipe), business methods, strategies, tactics, or any other piece of information that gives the business a competitive advantage. In the case of trade secrets, the focus of due diligence should be on the degree of security that is being directed to maintain the secrecy of the most important trade secrets. The focus of this inquiry is twofold: to determine whether the security level is sufficient to qualify the information as a trade secret and to suggest additional or alternative secrecy measures that the acquiring company may consider. This is must as reasonable efforts must be made to maintain a trade secret’s confidentiality. Trade secret protection can be lost through failure to demonstrate such efforts. The buyer should ensure that the seller has executed confidentiality agreements with all the employees, consultants and outside parties.

6.3.9. Tax Considerations

Where in amalgamation, patents or copyrights are transferred, the amalgamated company is entitled to tax benefits under section 35A(6) of the Income Tax Act, 1961. The expenditure on patents and copyrights not written off shall be allowed as deduction to the amalgamated company. Similarly, expenditure on know-how by amalgamating company is also allowed as deduction to the amalgamated company under section 35AB(3) of the Income Tax, 1961. Thus, transfer of intellectual property rights in merger or amalgamation makes the amalgamated company entitled to many tax benefits.

In addition to the above tax savings, the buyer can also structure his transaction in a most tax efficient manner. He may choose not to simply obtain record title to intellectual property assets received in a merger or acquisition, rather, it may choose to sell its newly acquired intangible assets to a third party and receive a license to use the


same. This can be achieved in the most tax efficient manner by placing ownership of the intangible assets in a holding company which then licenses back the assets for use by the operating company.  

Thus, intellectual property rights have acquired enormous significance for Indian companies undergoing M&As. So, the due diligence methods highlighted above should be given due weightage by company undergoing mergers in India to ensure their success.

6.4. Human Dimensions in Mergers and Acquisitions

“Always recognize that human individuals are ends, and do not use them as means to your end.”

Mergers, amalgamations, acquisitions, takeovers, or any other kind of business combinations are undertaken for the purpose of expansion or growth of a business. However, there is more to such transactions than joining two legal entities or creating a new one. A merger can join two cultures, two sets of procedures and protocols, two sets of policies and change the employment environment and prospects of several hundreds of employees, who have been the bedrock of past successes and the key to future values.

The merging entities give great importance to financial matters and the human resource issues are the most neglected ones. A study by KPMG revealed that the overwhelming cause for failure is the non-integration of human resources of both the transferor and transferee companies. People issues have been the most sensitive as well as the often ignored issues in a merger and acquisition. When a decision is taken to merge or acquire, a company analyses the feasibility on the business, financial and legal fronts, but fails to recognise the importance attached to the human resources of the

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organisation involved. Companies which have failed to recognise the importance of human recourses in their organisations and their role in the success of integration have failed to reach success.

Employees related issue is one of the intangible issues involved in any merger or acquisition transaction. Despite all tangible synergies available with the post consolidated entity, the whole plan may succumb to resentment from the employees. Unifying both groups of employees under one umbrella is definitely a difficult task as the working style, practice and culture etc. of the amalgamated companies may differ.\textsuperscript{207}

No doubt, with mergers and acquisitions our own regional or national companies have gone places and have acquired companies in places hitherto unknown on the global map and they have become a force to reckon with on international platforms. But such news often does not spell good news for employees who are often earmarked for the chopping block while making way for the organisation to be leaner, stronger and competitive.\textsuperscript{208}

In 2010, when merger of Bank of Rajasthan with ICICI Bank was announced, it was met with widespread employees agitation, or we can easily quote the case of merger of Air India with Indian Airlines in this regard which caught everyday’s headlines for its employees objection towards the merger. This merger has failed to convert to synergy due to employees agitation and dissatisfaction.

But unlike this case, when Procter and Gamble announced that it would buy Gillette for 57 billion dollars, the fact that 6000 people would lose their jobs was all but buried in the details of a deal that linked some of the world’s most well-known household brands.\textsuperscript{209} In UK, the data from Eurostat Labour Force survey suggests that 1,30,000 jobs have been lost in the last ten years as a result of mergers and acquisitions in the financial services sector only i.e. banking and insurance.\textsuperscript{210} In USA, the proposed merger between Monsanto and American Home Products deal was called off, Monsanto

\begin{footnotesize}
\begin{enumerate}
\item M. Govendrajan, “Rights of Employees of a Transferor Company in Formulation of the Scheme of Amalgamation”, \textit{SEBI and Corporate Laws}, 4 May 2009, Vol. 91, pp. 75-82, p. 75.
\item “The Impact of Acquisition in the Banking and Insurance Sector”, retrieved from \url{http://library.fis.de/pdf-files/netzquelle/01546.pdf}, accessed on 11 April 2012 at 3:00 pm.
\end{enumerate}
\end{footnotesize}
shares lost 24 percent in the announcement, AHP’s shares fell by 10 percent. The main issue between the two companies was cultural and managerial differences.\textsuperscript{211} A study by the A.T. Kearney consulting firm reviewed 155 mergers and acquisition deals in multiple industries and determined most failures to be people-related.\textsuperscript{212}

As the above illustration of various corporates clearly indicates that the root cause of failed mergers is mainly mismatch of cultures of the two companies. In spite of overwhelming evidence of the importance of human resources in mergers and acquisitions, they are often ignored as more stress is laid on financial aspects of the transaction. This is the main reason for including human dimensions of mergers and acquisition as one of the important aspects of my thesis.

6.4.1. Corporate Reorganisation and Employees

Leader’s imprint their organisations with their distinctive style of functioning. Consequently, each organisation will have its distinctive ethos and culture. For instance, one company may be run as a personal fiefdom whereas another might be professionally managed. One might be managed dictatorially, while the other might encourage participation. As a result, when two companies merge, there is likely to be clash that will involve a sea change in manpower policy. Such a change can endanger goals of the amalgamation. Differences in the two organisational cultures involved in a merger or acquisition and how they are managed are crucial to the success or failure of the process.\textsuperscript{213} The M&As often prove to be traumatic for the employees of the acquired firms, as they result in stress on the employee which is caused by the difference of human resources practices, uncertain environment, cultural differences, differences in the organisational structure and changes in the managerial styles.

It also leads to distrust, misunderstanding, poor coordination, hostility towards the acquiring company, job loss, relocation etc. Ernst and Young (1994) conducted a study and concluded that “There is increasing evidence that cultural incompatibility is the single largest cause of shortfalls in projected performance, departure of key executives

\begin{itemize}
\item \textsuperscript{212} Lublin and O’ Brien, 1997 as quoted in V. Marriappan, 2003, p. 85.
\item \textsuperscript{213} Vishal Majhee, “Analysis of Employment Effects of Takeover and Mergers and Acquisitions”, \textit{Dissertation}, Indian Law Institute, New Delhi, 2010, p. 47.
\end{itemize}
and time consuming conflicts in the consolidation of business. Corporate Leadership Council (2003) conclude that upto 85 percent of M&A failures are attributable to problems in the integration of the employees and the management of cultural issues in the merger or acquisition.

Thus, merger is a period of great uncertainty for the employees of the merging organisations. The possibility of a change in compensation and benefits creates a feeling of insecurity, unease, fear and resentment. The influx of new employees into the organisation can create a sense of invasion at times and ultimately leads to resentment. Further, the general chaos which follows any merger results in disorientation amongst employees due to ill defined role and responsibilities. This further leads to frustrations resulting into poor performance and low productivity since strategic and financing advantage is generally a motive for any merger. The difficulties encountered in management of human resource in M&As are amplified in cross-cultural situations, when the companies involved are from two or more different countries.

Another problem arises when the parent company feels compelled to bring about a reduction in the team size, in order to streamline its operations. This forced reduction, can lead to a series of wrongful termination and law suits. Most of the acquiring firms want to fill the top level jobs with their employees due to which top level managerial employees of the target company are removed. Many times the employees are directly or indirectly removed from their jobs after the merger. In the Sun Pharma-Ranbaxy merger, nearly half of the members of Ranbaxy’s executive committee exited after the merger of the two companies. No reason was disclosed for their exit officially. But insider sources say that the reason for exit is the difference in working conditions of the two companies. Many executives described themselves as ‘extremely stressed’ during the mergers and acquisition process. Many of the stressors that accompany merger activity are job uncertainty, transfers, new performance evaluation criteria, changes in

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215 Ibid.
reporting relationship etc. This may further lead to psychological symptoms such as depression, anxiety, loss of self-confidence, instability, irritability, marital/family strife, identity loss and negative attitude. If managements are sensitive to these common problems and adequately prepared for them prior to the merger, the resulting loss of talent, energy and productivity will be reduced.²¹₈

Thus, the importance of proper management of human resources of the organisation is beyond any doubt proved. It is amply clear that centrality of cultural integration should not be forgotten. Moreover, issues of cultural integration and human behaviour need to be at least addressed simultaneously along with issues of financial and legal integration if not well before.

6.4.2. Possible Impact of Merger on Employees

Upto the point in the transaction where the papers are signed, the merger and acquisition business is predominately financial-valuing the assets, determining the price and due diligence. Before the ink is dry, however, this financially driven deal becomes a human transaction filled with emotion, trauma and survival behaviour. In the case of international mergers and acquisitions, the complexity of human phenomena is often compounded by the difference in national cultures. People living and working in different countries react to the same situation or events in very different manners. Therefore, a company involved in an international merger or acquisition needs to consider these differences right from the design stage if it is to succeed.²¹⁹

The dynamics involved in combination process give rise to different kinds of uncertainties and ambiguities in the process. First, intense feeling of ‘we versus they’ in the organisation: this results in distrust, misunderstanding and poor coordination. Second, there are tensions and hostility towards the acquiring company. Third, anxieties on account of the transfers, job loss, relocation and loss of individual influence and cultural clash which arises when dissimilar cultures come into contact with each other. The consequences of cultural clashes are characterised by employee stress, distrust on

the part of members of one firm towards the member of other firm and negative attitudes towards each other. The negative attitude reduces the commitment of members to successful integration of the organisation and the extent to which they are willing to cooperate with the other organisation.\textsuperscript{220}

\textbf{(1) Cultural Shock:} The organisational culture pays an important role during mergers and acquisitions as the organisational practices, managerial styles and structures to a large extent are determined by the organisational culture. Each organisation has a different set of beliefs and value systems, which may clash owing to the M&A activity. The exposure to a new culture during the M&A leads to a psychological state called cultural shock. The employees not only need to abandon their own culture, values and belief but also have to accept an entirely different culture. This exposure challenges the old organisational value system and practices leading to stress among the employees. Research has found that dissimilar cultures can produce feeling of hostility and significant discomfort which can lower the commitment and cooperation on the part of the employees. In case of cultural clash, one of the cultures that is dominant culture may get preference in the organisation causing frustration and feelings of loss for the other set of employees. The employees of non-dominating culture may get feelings of loss of identity associated with the acquired firm. In certain cases like acquisition of a lesser known or less profitable organisation by a better one, the result will be feelings of superiority complex among the employees of the acquiring organisation. In case of hostility in the environment, the employees of two organisations may develop ‘us’ versus ‘them’ attitude which may be detrimental to the organisational growth.\textsuperscript{221}

\textbf{(2) Uncertainty:} With the merger of two companies, there may be duplication of certain departments, which have to be avoided. Therefore, excess manpower will have to be removed in certain cases. Therefore, mergers or acquisitions may bring fear of job losses in mind of the employees which bring job uncertainty and leads to loss of productivity.


\textsuperscript{221} Divi Jain, 2008, p. 117.
(3) **Loss of Trust:** If the human resource of an organisation are not paid due attention in a merger, in some instances, the employees can become distrustful of the new entity. This may in turn lead to lack of co-operation on their behalf, absenteeism from work, low productivity and so on. Thus, negative human response to a merger or acquisition could be extremely costly to an organisation and could easily undermine aspects of the corporate strategy that led to the activity in the first place. 222

(4) **Differences in Matters of Compensation and Grading:** Two companies which merge have difference in the level of compensation paid to their employees and designation used for employees are also different as organisational structures are different. Hence, the possibility of a change in their position is likely to be viewed with fear, resentment and loss of morale. It, therefore, need to be taken care of failing which the situation may get so aggravated so as to cause serious harm to the new company. Such differences in compensation structure, performance appraisal and grading system need to be rectified so as to bring equality among human resources of the organisation. In HLL-TOMCO merger, the issue of difference in compensation arose as TOMCO employees enjoyed better terms and services compared to the HLL employees. This caused dissatisfaction to HLL employees. So, the compensation differences need to be rectified by the acquiring firm so as to maintain the morale of the employees.

(5) **Infrequent and Irrelevant Communication:** Fear and a lack of all the answers deters top management from providing the information to the employee that they need to redirect their action. Rumors fill mystery and vacuums. 223 Communicating can make or break staff acceptance of a merger or acquisition. A lack of communication can exacerbate other problems that arise as a result of M&A. 224

6.4.3. Confronting the Barriers: Turning Challenge to Opportunity

We have already discussed the problems faced by human resources in any merger or acquisition transaction. Precisely because these challenges are so much a part of the landscape of M&A, it is important for corporate leadership to actively seek solutions

222 V. Mariappan, 2003, p. 89.
that are affordable and that take into account the real financial and time pressures attendant to any deal.

(1) Communication: Communication is the most valuable commodity for the successful implementation of a merger or acquisition. Clearly defined communication strategy during M&A plays an important role in removing the employee fear and kill rumours floating around in the organisation. The organisations need to reach their employees before the press as the employees will have feeling of getting cheated. Because if they get communication from outside, it can lead to a distorted or misrepresented picture of the acquisition’s ramifications and it may lead to counterproductive activities by employees, who may be anxious about possible job losses.

It is very important for management to communicate clearly and regularly to all employees the implications of the merger, including the planned changes to working practices and organisational processes. To be effective, the communication process has to be carried out in such a way as to avoid confusion and mixed messages. The communication process should also encourage two way feedback between management and employees to make employees feel that they are contributing to the solution. By involving people at all levels of the organisation, the merging companies are encouraging widespread acceptance of the merger process and reducing feelings of insecurity. Cartwright and Cooper pointed out that whenever possible, corporations should aim to inform all employees at the same time, conveniently (with) or in advance of any press release or radio announcement. Thus, communication is the lynchpin holding the M&A process together.

(2) Management of Cultural Differences: Successfully integrating the two cultures of the merging firms is an essential step towards achieving a successful partnership. Both organisations, the acquiring and the acquired, will have unique and beneficial cultural

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elements. Rather than imposing one organisation’s cultural elements on the other, the best of both companies can be integrated into a common culture for the new organisation. This can create a win-win situation for both organisations since it will result in a corporate culture with which both sides can identify. Conducting a cultural audit is a useful way of obtaining useful information about the two companies differing cultures and helps to evaluate differences and similarities in work standards and practice. Thus pre-merger survey of varying cultures of different companies merging needs to be carried out. People belonging to each defined culture need to be acquainted with cultures of other merging companies. They need to be mentally prepared to adopt the good points of other cultures and shed the blockades of their own cultures. Such an open approach will make the fusion of culture and ethos easy and effective.

(3) Providing Training, Development and Counseling to Employees: Training should be provided to top and middle level employees to educate them on implication of mergers and prepare them to handle them effectively. Such interventions will facilitate more effective leadership on the part of the managers who will have a better understanding of the key issues that arise during the course of a merger. In addition, individual counseling should be provided to all the employees so that they can cope up with stress and job uncertainty created due to merger.

(4) Promote Co-operation: Differences in compensation and grading should be removed at the earliest as this may create two categories of employees in the organisation which will ultimately effect the work of the organisation. This ‘them-us’ syndrome should be removed at the earliest by bringing uniformity in pay scales, designation, grading system etc. Moreover, acquiring organisations should try to eradicate any arrogance on the part of their personal to ensure that acquired employees do not feel inferior and conquered.

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230 Ibid.

231 The Institute of Company Secretaries of India, 2010, pp.131-132.


(5) Retention of Talented Workforce: The retention of talented workforce should take priority during the merger process and management need to take steps at the earliest to improve the retention rate of the key employees of the merging companies. Effective reward strategies will reduce employee’s sense of insecurity and give a better picture of what the future holds for them.

(6) Contingency Planning: Contingency Planning is at the core of any sensible merger or anti-merger strategy. Companies must plan for the possibility of a hostile takeover. In fact, the employers of the company, which is a merger or takeover target face a ‘lose-lose’ situation. Therefore, a merger planning team should be constituted. This team should meet on a regular basis to prepare and reverse contingency plans in consultation with legal and financial department and address specific problems such as:\footnote{J.C. Verma, 2009, p. 334.}

(a) The cultural issues;
(b) The designation of cross-functional merger integration teams;
(c) Employee retention;
(d) Organisational development and change strategies.

The output of the contingency planning teams should include pre-merger and post-merger training and development packages. The pre-merger training and development plans should address the needs of senior managers by fully acquainting them with the nuances of the merger process. The post-merger training package should be prepared so that it can be used when required.\footnote{Id., pp. 335-336.}

(7) Employee Involvement and Interaction: Involvement of employees in building the policies, systems and procedures helps them inculcate a feeling a belongingness and they are more sensitive to the success of the merger or acquisition. In case of isolation, employees tend to assume physiological and psychological stress causing clashes, disloyalty and lowered morals and productivity.\footnote{Id., p. 337}
Thus, human resource integration is absolutely critical to success of mergers and acquisitions. It is one of the very important steps for realizing synergies in a merger and positioning the new firm for growth. Effective integration enables the merging firms to realise the strategic potential of the deal.

6.4.4. Case Studies

The two classical examples of effective human resource management are discussed hereunder:

6.4.4.1. Glaxo-Wellcome Group Acquisition: Glaxo’s acquisition of Wellcome group had to face a lot of integration problems as both group’s work and organisational structure was profoundly different. Both these drugs manufacturing companies had differences in their work culture, finance, sales promotion, information technology etc. Wellcome focused more on research whereas Glaxo was more of commercial and business driven culture. Wellcome was an over-centralized organisation using outdated technology whereas Glaxo was commercial and profit centered organisation using latest high-tech research technology.

To try to combat such differences, the management declared that both old companies were history and a new company was to be built in its place. But due to the merger of both the companies, certain manufacturing units had to be closed down to cut down on excess costs and realise merger synergies. This led to lay-off of excess staff. But Glaxo management did not want to give an impression that it was steamrolling Wellcome as this could have created unrest and dissatisfaction among the Wellcome’s staff.

In order to overcome such a situation, the Glaxo management came out with a very lucrative package which was an expensive solution to the problem but was unavoidable to properly integrate human resources of both the organisations and to ensure the success of the takeover. An organisation named Competence Plus was established. Employee who were laid-off were made part of it. The organisation’s main purpose was to impart training to the laid-off employees on new skills and technology. They were paid full salary during the training period. The organisation helped the employees in the process of placements in other companies. The new group paid for their salaries for the trial period of their job in other companies. Whenever any vacancy arose in the new
Glaxo-Wellcome group, the laid-off employees were the first to be interviewed. The working hours and other conditions were made uniform for the employees of both the companies. The Glaxo-Wellcome acquisition can be cited as a perfect example of effective human resource management.

6.4.4.2. Tata Tea’s Merger with Tetley: The Tata-Tetley tea merger was one of the rare example of an Indian company taking over a foreign company bigger than it in size. The success of the merger was found in complementing each other with their differences rather than conflicting and creating trouble. Tata group was aware that it needed to be sensitive to the potential cultural differences that existed between the two companies and tried to blend the two cultures. Initially, the two companies faced certain problems in cultural integration as Tetley was process oriented and Tata an action oriented (i.e. quicker to respond). Tata executives complained of not being treated well when they visited Tetley’s UK head office despite being the senior partners. Tetley complained about Tata’s lack of knowledge and expertise in handling markets in western countries. Both the groups handled these problems effectively before they could cause any harm or loss to the merger. Instead of trying to dominate the other group, they worked towards adding to each other’s knowledge and skills and lead to success of business. Both the companies decided to leave behind their separate cultures and move towards unifying their cultures. The new group was sensitive to the problems of human resources of both the companies and by pre-estimating their problems and adopting a correct approach, lead to success of merger and improvement in Tata-Tetley merger results.

Now let’s study some cases, where improper human resource management, put hurdles in the path of successful mergers. Here are a few illustrations:237

- In the case of Thermax System Software (TSS) nearly 2/3rd of the employees left TSS after it was acquired by Global Tele Systems.

- The joint venture between Proctor and Gamble and Godrej collapsed due to the lack of human resource synergies in the two organisations.

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• When Sify’s e-business division was merged with Satyam, the merger created a lot of technical confusion, which was caused on account of differing views of the employees on issues related to technology integration and development practices. The human resource department was found to be clueless and solutionless in this situation.

6.4.4.3. Air India-Indian Airlines Merger (Improper Human Resource Management):
The merger of Air India and Indian Airlines was approved by the Government of India on 1 March 2007. Consequent to the above, a new company called National Aviation Company of India (now called Air India limited) was formed and incorporated under the Companies Act 1956 on 30 March 2007 into which both Air India and Indian Airlines were merged. The aim of the merger was to create the largest airline in India which provided integrated international and domestic coverage with optimal utilisation of resources. Both Air India and Indian Airlines were profitable ventures till 2005 before the merger despite being government entities. But it was not so after the merger. It was expected that merger of two entities would result in a profit of Rs. 1000 crore in the first year itself. Instead, in three years following the merger, the losses escalated from Rs. 1200 crore in the first year to Rs. 2600 crore in the second year to Rs. 5500 crore in the third year. The inescapable fact is that airline today has accumulated losses of Rs. 16000 crore. This merger has to be put in the category of failed merger. The most prominent reason for its failure has been lack of integration of human resources of both the entities. A leading magazine quoted the reason as follows.

“A virtual stand still regarding the integration of 27000 employees over the last five years has meant that no constructive action has been taken on human resource integration of the two airlines. Two sets of employees following disparate systems and processes were forced into an abrupt wedlock.”

It was a great plan or idea to merge them but it turned out to be a marriage between two incompatible partners having wide variances with hardly any meeting ground ultimately leading to human resource problems. According to the report of the Dharmadhikari Committee set up to solve the HR problems created by the merger said:

“The task of suggesting ways and means of harmonisation and rationalisation of the huge work force of the merged entity i.e. Air India has been assigned to the Committee headed by me. We found it a challenging task as even after more than four years, the merger was mostly on paper in so far as the integration of manpower was concerned. We could realise a deep sense of frustration and mistrust among the employees of two merged entities.”

The whole set of events leading to strike occurred as follows: At the time of merger of the two national carriers, it was time and again reiterated that Indian Airlines and Air India staff are two arms of the National Aviation Company (NAC) and that there would be no discrimination between the employees of two outfits. What happened was totally different from what was assured, as no attempts were made to standardise hiring policies for the rank and file. Air India employees worked five days a week whereas Indian Airlines employees worked six days a week. Indian Airlines pilots were promoted unconditionally once in six years while Air India pilots were promoted only after ten years and that too if only there was a vacancy. The ground handling teams of the two airlines continued to operate separately even after five years of merger.

To add fuel to the above differences, Indian airlines was virtually liquidated from the skies and all the eggs of national skies were cramped into the belly of Air India. This caused huge unrest among Indian Airlines staff who lodged several protests and complaints. The entry of ‘Dream liners’-wide bodied Boeing 787 promised to help turn

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the things around for Air India. Instead they threw the existing state of affairs into further turmoil. The present management chose some commanders and senior pilots from the family of Indian Airlines for training on this new airbus.\textsuperscript{245} But this decision hurt the team of Air India pilots who protested against the inclusion of the Indian Airlines pilots in flying this wide bodied aircraft. According to Air India pilots, it was their forte to fly this wide-bodied aircraft.

Distributed at the management decision, the Air India’s pilot supported by their union, went on ‘mass leave’. The ongoing pilot’s agitation has resulted in cancellation of several flights including many international ones, causing passenger inconvenience and a loss of over Rs. 350 crore to the exchequer.\textsuperscript{246} But the strike had to be terminated due to the order of the Delhi High Court terming the strike ‘illegal’. The end of the strike at the behest of the court order was only a ‘temporary measure’.\textsuperscript{247} Because it did not improve the situation, rather, it left the national carrier which was utterly crippled in utter chaos and turmoil. The losses mounted after the strike leaving the carrier in a virtual state of coma.\textsuperscript{248}

All these above facts clearly emphasise the fact that the reasons for failure of Air India-Indian Airlines merger was the plethora of the human resource issues. That’s why, Government realised its mistake and expert committee under the chairmanship of D.M. Dharmadhikari, former judge of the Supreme Court of India was appointed. The Committee recommended measures for the integration of human resources of the merged entity. It recommended parity in pay scales and working hours in the merged Air India. This also means that pilots, whether those flying narrow-bodied or wide-bodied aircraft will be treated equally. The pilots, engineers and senior staff would get allowances as per industry standards.\textsuperscript{249}

To sum up, we can say that as more attention was devoted to discussion around non-core issues such as long term fleet acquisitions, establishing subsidiaries for ground

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\textsuperscript{245} Ibid.
\textsuperscript{246} “Air India Plan”, \textit{The Tribune}, 15 June 2012, p. 1.
\textsuperscript{247} “Pilots Strike Over, Situation Yet to Become Normal”, \textit{The Tribune}, 9 July 2012, p. 15.
\textsuperscript{248} Ibid.
\textsuperscript{249} “Air India–Indian Airlines Merger, Government to Begin Implementing Dharamadhikari Report”, \textit{The Tribune}, 2 June 2012, p. 19.
\end{flushleft}
handling and maintenance, then on human resources—one the most precious asset of any organisation, lead to a potentially merged messy situation for the merged enterprise. Government has tried to mend the situation five years after the merger when the turn around has become a herculean task. We will have a see how the situation progresses from here now.

6.4.5. Terms of Agreement of Employment in Merger

Labour laws of our country do not give rights to employees to bargain with the acquirer or transferee company in case of amalgamation. But section 25FF of the Industrial Disputes Act provides for measures for the protection of employees in case of merger. These measures are in the shape of compensation and imposition of conditions on the transferee company for absorbing employees of the transferor company. Section 25FF provides for fulfillment of following three conditions to protect the interest of the employees of the transferor company which are: 250

- The service of the workman should be uninterrupted by such transfer.
- The terms and conditions of service applicable to workman transferred should be similar or more favourable then which were applicable to him before the transfer.
- In case of retrenchment of the employee, the new employer is liable to pay retrenchment compensation to the employer on the basis that his service has been continuous and has not been interrupted by the transfer.

That’s why, in an amalgamation process, the agreement in respect of the employees generally contains the following terms: 251

- All the employees of the transferor companies will be transferred to the transferee company from the effective date without any discontinuation.
- Employees of the transferor company shall not get less benefits than those of the transferee companies.

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250 For details, see, M. Govindarajan, 2009, p. 76.
251 Ibid.
Employees related benefits such as provident fund or gratuity funds are also transferred to the transferee company.

These type of terms in the agreement reassures the employees about the safety of their job besides preventing them from joining the litigation along with the opponents of the scheme. There could be slight variations or addition in these terms provided they do not harm the interest of the employees. Let us take one illustration to clear the above point.

**Merger of Reliance Petrochemical Industries Ltd. (Transferor Company) with Reliance Industries Ltd. (Transferee Company):** In the amalgamation agreement, the following clause was inserted which is reproduced below:

> “The transferee company, will with effect from the ‘appointed date’, take over all the employees of the transferor company, as its own employees on terms and conditions of service not less favourable and without any break or interruption of service.”

This clause is contained in most of the amalgamation schemes and is a typical one. But illustration of this merger is given here as in addition to the above lines, the following additional words were added. The position, rank and designation of the employees of the transferor company would be decided by the transferee company. So slight variations and additions to the typical clause are allowed.

**6.4.6. Relevant Case Laws**

The M&As are generally accompanied by changes in the overall rate of employment of the enterprises involved. The most unusual development is the reduction in the total number of employees, followed by period of stability and then increase in employment. If the workers feel that their rights are prejudiced by any scheme of merger, they can raise their objection when the court hears the petition for approval of the scheme.

In *Hindustan Lever Ltd., In re*, the Bombay High Court held that the court must take into consideration the interest of employees of the companies and the public interest to ensure that their interest is not affected and provision is made for them. This is because

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253 Ibid.
254 (1994) 3 Comp LJ 46 (Bom.).
this class of persons who are affected by the scheme have no locus standi in the meetings and the judgement of the majority in their regard need not necessarily be of a great value or a safe guide.

In *Manipal Hotels Ltd., In re*, the scheme gave different terms and conditions for the permanent and temporary employees, the court modified and sanctioned the scheme on the condition that the services of certain temporary employees shall be protected in the same manner and extent as that of permanent employees.

**The Supreme Court’s Judgement on the Rights of the Employees:** A change in the management, either by acquisition or through merger, creates lots of uncertainties in the minds of employees, more particularly, in the case of transferor companies’ employees. The fear of transfer and retrenchment, the loss of position in the hierarchical level are some of the thoughts which loom large in the minds of the employees of both the companies. The employee’s union also feels and sometimes acts in a detrimental way by opposing the amalgamation. In the case of HLL-Tomco merger, the position of employees consequent upon merger was discussed in detail by the judges. The HLL and TOMCO employees both contended that the amalgamation scheme failed to protect the interest of employees of both companies and thus violative of public interest. But hon’ble Apex Court held that the scheme has fully safeguarded the interest of the TOMCO employees by providing that the terms and conditions of their service will be continuous and uninterrupted and their service conditions will not be prejudicially affected by reason of the scheme. The employees made a grievance that there is no job security of the workers after the amalgamation of the two companies. But the court replied that there was no assurance on behalf of the TOMCO that the workers will never be retrenched. In fact, the performance of TOMCO over the last three years was alarming for the workers. It cannot be said that after the amalgamation they will be in a worse position than they were before the amalgamation.

The court did not find that the amalgamation has caused any prejudice to the workers of TOMCO. The stand of the employees of HLL was found equally incomprehensible. It

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was further contended that if TOMCO employees continue to enjoy the terms and conditions of their service as before, then two classes of employees will come into existence. Terms and conditions of HLL employees were much worse than that of TOMCO employees. If there are two sets of terms and conditions under the same company, than a case of discrimination will arise against the HLL employees. The court did not find any substance in this contention. TOMCO employees will continue working under better terms and conditions as they were getting before. Because of this arrangement, it cannot be said that a prejudice has been caused to HLL employees. They will still be getting what they were getting earlier.

The court found that the interest of the employees have been adequately protected as the scheme of amalgamation provides that all the staff, workmen or other employees in the service of the transferor company immediately preceding the effective date shall become the staff, workmen and employees of the transferee company. Clause 11.1 provides that their services shall be deemed to have been continuing and not have been interrupted. Clause 11.2 and 11.3 protect the interest by providing that the terms and conditions of such employees shall not be less favourable and all benefits such as provident fund etc. shall stand transferred to the HLL. According to the hon’ble court, the grievance of the employees that no safeguard has been provided for Hindustan Lever Employees Union appears to be off the mark as it is the interest of the employees of TOMCO which had to be protected. Even the submission that merger will create unemployment or that it may result in many employees of the TOMCO being rendered surplus does not carry much weight as these are matters which can be taken care of by the labour court if the contingency arises.

A scheme of amalgamation cannot be faulted on apprehension and speculation as to what might possibly happen in future. The present is certain and taken care of by clauses 11.1, 11.2 and 11.3 of the scheme. And unfriendly throwing out being amply protected by taking recourse to labour court. Therefore, no unfairness arises apparently or inherently. According to the Supreme Court, improved technology and scientific method results in better employment prospects. Anxiety should be to protect workers and not to obstruct development and growth. May be that advanced technology may reduce the manpower but so long those who are working are protected they are not
entitled to hinder in modernisation or merger under misapprehension that future employment of same number of workers may stand curtailed. Thus, Supreme Court has done a commendable job in smoothening the fears of the workers of both the companies and thrown ample light on what can be done for proper management of human resource in mergers.

In *Willcox Buckwell India Ltd., In re*, the Delhi High Court said that no workman can be compelled to work in the transferee company on a pay scale which is less than that he was getting in the transferor company, and where the service conditions in the two companies are not identical, the workmen are entitled to all the benefits including retrenchment compensation, etc., as entitled under the law upon termination. In *Bharatiya Kamgar Sena v. Geoffrey Manners and Co. Ltd.*, the court ordered a secret ballot to ascertain the wishes of the employees and ordered that retrenchment benefit must be provided to those employees who did not like going over to the transferee company.

In the recent judgement of *Rajeev S. Mardia & Rasik S. Mardia, In re*, the High Court of Gujarat refused to sanction the scheme of amalgamation as there were many lapses in the scheme. One of them was that there were no concrete proposals with regard to satisfaction of dues of workers or re-employment of such workers. So, such is the importance of human resources in mergers. In *KEC International Ltd. v. Kamani Employees’ Union*, the Bombay High Court held that the scheme shall adequately provide and protect the rights of the employees of the transferor company as well as transferee company. Where any scheme affects the rights of employees prejudicially, the employees have a right to oppose it. The Trade Union representing them would have locus standi to raise objections.

### 6.4.7. Extent of the Rights of the Employees in a Merger Scheme

The extent of the rights of the employees in a merger scheme has been given exposition by various courts. In *Bank of Baroda v. Mahindra Ugine Steel Co. Ltd.*, the court...
must take into account the interest of the employees and ensure that their interests are not adversely affected and that adequate provision is made for them. In any event the employees have no locus standi in the meeting and the judgement of the majority is of greater value.

In *National Textile Nehru University v. P.R. Ramakrishnan*, it was held that sections 391 to 394 do envisage the employees to object to any scheme which involves arrangement-mergers etc. Further the employees are also not required to be made as parties in a petition for sanctioning a scheme. The employees only have an opportunity of being heard applying the principles of natural justice.

In *H.L. Trehan v. Union of India*, the facts of the case were that a petroleum company was taken over by a government undertaking through a legislation where there was a proposal to change adversely the service conditions of employees, the Supreme Court held that the same could have been done by fulfilling the requirements of natural justice requiring an opportunity of being heard to be given to employees.

This controversy on position of employees in a merger has been put to rest in the landmark judgement of Gujarat High Court in 2008 in *IPCL Employees Association v. IPCL*. This judgement upheld the position of the workers in the company mergers and amalgamations. This judgement is of far-reaching impact as it came out in the wake of the amalgamation of Indian Petrochemicals Corporations Limited (IPCL) and Reliance Industries Ltd. (RIL). The scheme of amalgamation along with the transfer of undertaking of IPCL also provided for the transfer of all employees of IPCL to RIL. The Employees’ Union objected to the scheme of amalgamations on the following grounds:

- The scheme and the prayer made by the company before the court simply provided that the workers of IPCL would become the workers of Reliance Industries Limited on the granting of the sanction. This amounted to treating the workers as simply chattels who could be shunted from one place to another.

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262 AIR 1983 SC 75.
263 AIR 1989 SC 568.
264 (2008) 84 CLA 104 (Guj.).
It was further alleged that the workers had never been informed about the scheme of amalgamations; they had been kept far away from the negotiation proceedings; they had neither been given notice regarding the same nor the opportunity to represent the case and never allowed to participate.

The Gujarat High Court was faced with the following issues:

- Workers’ rights to participate in formulation of the scheme of amalgamation;
- Transfer of employees of transferor company to transferee company without their consent;
- Rights of employees of transferor company who do not opt to join transferee company;
- Conditions of services of workmen of transferor company after amalgamation.

In regard to the first issue, the court held that a conjoint reading of sections 391 and 394 of the Companies Act makes it amply clear that the workmen of the transferor company have no legal or statutory right of holding meeting and to express their opinion on the question of amalgamation. But the workmen of the transferor company do have the locus standi to express their view before the company court when the proceeding under sections 391 and 394 are pending.

Regarding the second issue, the court held that while the consent of a workman is not necessary for transfer of undertaking, his consent is certainly required for his absorption in the service of the new employer. Such consent need not be expressed in writing or individual by every employee. It should be suffice if a workman who do not desire to join the transferee-company is permitted. The High Court further held that the contract of employment being personal in nature, cannot be transferred from one employer to another employer without the consent of the employees and as such, a transfer is a tripartite agreement between the transferor company, the transferee company and the workers of the company.

Regarding the third issue the court held that in case of employees of the transferor company who are not ready and willing to serve the transferee company, cannot be denied retrenchment compensation payable under the substantive part of section 25FF.
of the Industrial Dispute Act, which creates the fiction of retrenchment upon transfer of ownership of management of an undertaking.

Regarding the fourth issue, the court observed that the scheme clearly provides that upon amalgamation taking place and the employees of the transferor company becoming employees of the transferee company, this by itself cannot entitle such employees to claim all the rights, benefits and privileges which were available to the employees of the transferee company prior to amalgamation. If the employees of the transferor company after amalgamation seek to claim better conditions of service, they can approach the appropriate forum and that those proceedings will be disposed of in accordance with law by appropriate authorities under the relevant statues.

In view of the above discussion, the Gujarat High Court confirmed the order of the Company Court granting sanction to the scheme of amalgamation of IPCL with RIL.

6.5. Conclusion

First of all, let's conclude the first emerging dimensions i.e. the rising trend of cross-border mergers in India. With technology, communications and global networking evolving rapidly, corporations restructure almost on an ongoing basis to keep with the change. Amidst various forms of corporate restructuring that are in practice today, cross-border M&As are gaining prominence.\(^{265}\) In India, the legal and financial reforms by the government of India since the early 1990s, easing of restrictions on foreign investment and acquisition has probably been the most significant catalyst for the growth of cross-border M&A transactions in India.

The most significant role for cross-border mergers and acquisitions is in encouraging longer-term reforms, such as operational restructuring and reallocation of assets, in firms. Foreign participation through M&As could also be more effective in improving efficiency, competitiveness and corporate governance.\(^{266}\) Before-and-after comparisons of cash-flow returns of acquired firms lead to the conclusion that acquisition bring wealth gains to distressed firms and that those gains are greater in cross-border M&A transactions than in domestic ones.\(^{267}\)

\(^{265}\) Bhagwan Jagwani, 2011, p. 1377.
India’s economic liberalisation in 1991 sparked fears that the country would be overrun by foreign multinationals. However, Indian companies have not only competed with foreign companies operating in India but also managed to compete with them in their home ground. Buoyant Indian economy, extra cash with Indian corporates, government policies and newly found dynamism in Indian businessmen have or contributed to rise in cross-border M&A in India.268

But Eurozone crisis and the recession in US, impacted us and cross-border M&A activity witnessed a decline. The downslide was also due to slowdown in reforms, rising interest rates, the depreciating rupee, slow GDP growth and the regulatory environment. The Bharti-MTN deal fallout was also due to strict regulations which do not allow dual listing and FDI policies and the takeover norms. No doubt, India has brought out drastic reforms in its legal and regulatory environment recently with legal recognition to cross-border mergers and contractual/short form mergers in the new Companies Act and relaxation of FDI norms regularly. Still, further reforms are required in the takeover norms, Competition Act, etc. To sum up, current times are clearly challenging (both from the economic and regularly perspectives) which had lead to moderation in deal making, but still the long term outlook on M&A in India remains robust.

In the researcher’s view, India’s M&A environment would continue to grow stronger and bigger in the year to come. The trend has been initiated by an upsurge of M&A activity in 2014 due to the optimism generated by the new Modi Government at the Centre. Overall, the speed of India’s entrance into global markets illustrates the natural urge of Indian businesses to take part in the global economy. Therefore, as western economies continue to show signs of weaknesses, Indian corporate should aim at seizing this time and opportunity to strengthen India’s market position while expanding their global footprint.

Now, lets shift our focus to second emerging dimension i.e. the importance of due diligence and valuation of intellectual property rights in mergers and acquisitions. It

is very important for a successful business in contemporary times, to be able to protect its intellectual property. As Intellectual Property is very important in the running of a company, the same must be protected at all cost. Above all, in M&A transactions, buyers and sellers need to approach these transactions with a strategy to maximise and protect the value of these assets. If a company is considering a merger or acquisition, it is important that all intellectual property contracts be carefully reviewed and analysed to determine if the merger may have an effect on the surviving entity’s ability to use the intellectual property at issue.269 This become more important as each deal is unique and has its own constraints, otherwise precious intellectual property rights may be lost due to failure to renew or non-prosecution of applications or proceedings. Conducting due diligence as outlined above by the researcher will maximise the likelihood that material issues will be identified and if possible remedied before closing the transaction. Companies must perform necessary due diligence in advance and ask for representation from the target company, in order to avoid any further disputes and litigation.

To sum up, we can say that as the global economy races towards an information-based economy, the intellectual property will be the dominant force in future commercial transactions like mergers and acquisitions. Since Intellectual Property has come to represent a major proportion of the business especially in R&D dominated enterprises like pharmaceutical sector, it is essential that the acquirer gets what he has paid for.270 This makes proper due diligence, valuation and audit of Intellectual Property Rights before entering M&A transactions indispensable.

Lastly, lets shift our focus to the third and the last emerging dimension in the field of mergers and acquisition i.e. rising importance of human dimensions in mergers and acquisitions. Unifying employees of both the companies under one umbrella is definitely a difficult task as the working style, practice and culture etc. of the amalgamated companies may differ. That’s why, one of the key issues the corporate sector is facing today with regard to mergers and acquisitions is management of human resources. Lack of attention to human resources in M&A can lead to whole lot of

270 Ibid.
physiological, psychological and societal problems for the employees and in turn for the
companies also.

Inspite of the overwhelming evidence of the importance of human resources in M&As, they are often ignored by companies undertaking M&As as more stress is laid on the financial aspects of the transaction. But they should be addressed simultaneously along with issues of financial and legal integration if not well before. Moreover, a company involved in an international merger or acquisition need to consider these differences right from the design stage if it is to succeed. These human issues could be handled smoothly with the help of well thought out and planned strategies. A well planned process built on the foundation of an open, honest and consistent communication strategy can pave the way. The success of a merger and acquisition depends on how well an organisation deals with issues related to its people and cultural integration.\(^{271}\) Human resources no longer play a dormant role and are emerging as an important strategic business partner. So, formulating strategies while ignoring employees can be critical for the organisation.

To conclude, we can say that takeovers and amalgamations have become a common place in our country’s business set up. There is a tremendous urge for people to grow and become global players, expanding their business spheres. But in this urge, companies should not forget about their human resources. If companies do not want any hurdle in their attempt to grow inorganically, they should adopt equal stress to human resource dimension as is given to financial, legal, operational and strategic concerns. If success has to be achieved in the market place, what is required is a cohesive, well-integrated and motivated workforce willing to take on the multifarious challenges that arise on the horizon from time to time. It is this aspect that’s needs attention, at the time of amalgamation, as in every other case.\(^{272}\)

\(^{271}\) Divi Jain, 2008, p. 123.