Chapter 6

Characterisation of the Merger Movement
Based on Detailed Case Studies

The main conclusion emerging from our discussion thus far is that the merger movement of the 1990s was driven by the need for business groups to restructure in the face of liberalisation, either by combining with unrelated companies with product or marketing profiles that provide for benefits of synergy from merger or through the consolidation of firms hitherto run as legally separate entities, but which were or had become companies controlled by the same management. Given the coincidence of the merger wave with the period of liberalisation, it does also appear that this drive towards consolidation was aimed at enhancing competitive strengths in a changing environment. While growth and market consolidation were significant benefits from consolidation, the other major motives for most of the mergers covered in our sample appear to be financial. Among the latter, the enhancement of the size of the controlling block of firms seeking to exploit the benefits offered by a liberalised and initially buoyant stock market, without exposing themselves to the growing danger of takeover was possibly an overriding consideration in choosing to restructure the traditional format of the typical unit of capital in the Indian corporate sector. As mentioned earlier, the evidence from our sample suggests that mergers of firms belonging to the same business groups appear to be dominate the merger wave. However, there are signs that mergers between unrelated firms, though numerically less significant, have been gaining ground. This is especially true of mergers
involving foreign-owned firms.

To correct for the bias towards related mergers inherent in the sample, we attempt in this chapter a detailed analysis of a few individual cases of merger in order to assess which of these motives dominated in particular circumstances, and to illustrate the manner in which these different motives articulated themselves in practice. In doing so, the main aim is to highlight the circumstances in which the motive of external expansion in the form of asset-growth or an increase in market share played a dominant role and those in which mergers occurred with the motive of internal financial restructuring to cope with the threats and opportunities characterising the new environment.

| Table: 6.1 Gearing Ratio of Acquiring and Acquired Firms Before and After Merger |
|------------------|-------|-----|-----|-----|-----|-----|-----|
|                  | T-2   | T-1 | Avg | T0  | T1  | T2  | Avg |
| HLL              | 4.24  | 4.7 | 4.47| 7.59|     |     |     |
| TOMCO            | 16.52 | 10.24| 13.38|     |     |     |     |
| NOCIL            | 5.3   | 6.14| 5.72| 9.35| 10.68|     | 10.68|
| Plyolefins Ltd   | 7.84  | 12.79| 10.315|     |     |     |     |
| ABB              | 23.37 | 11.16| 17.265| 11.89|     |     |     |
| Flakt India      | 8.87  | 6.82| 7.845|     |     |     |     |
| Gujrat Godrej Innovative | 4.58 | 2.68| 3.63| 11.76|     |     |     |
| Godrej Soaps     | 1.29  | 0.86| 1.075|     |     |     |     |
| Reliance Petrochemicals# | 0.71 | 6.98| 3.86|     |     |     |     |

Source: BSE Directory

# Data related to Reliance Petrochemicals is obtained from the company document. Total debt = secured loan plus unsecured loan.

* Total Debt = Long-term Loans
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Source: BSE Directory

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Source: BSE Directory.

Note: Data related to Reliance Petrochemicals could not obtained.

T-1 = The Year immediately before merger
To = The Year of Merger
T1 = The Year Immediately After Merger
PBTID= Profit Before Tax, Interest, Depreciation
Rate of Return = PBTID to Total Capital Employed
Profit Margin = PBTID to Net Sales
Gearing Ratio = Total Borrowing to Paid-up Capital
Total Borrowing = Total Liabilities- Provision for taxation
Long-term Loans = Deferred Liabilities- Debentures
Price Earning Ratio = Average market price of shares (i.e High and Low) to the Dividend per share
A striking instance of a merger which occurred with the objective of market expansion, is the merger of Tata Oil Mills Company Ltd. into Hindustan Lever. In 1993, Hindustan Lever Ltd acquired TOMCO, owned by an unrelated business house through a merger involving an exchange ratio of 1:0.133. Given the strong similarity between the major product lines of both these companies, it is obvious that an increase in market share and the consolidation of an oligopolistic position where an obvious objective of the merger. As per the scheme of amalgamation, the merger was justified on the grounds that it would increase the availability of financial, managerial, technical and marketing resources to the transferor company. Subsequent to the allotment of HLL shares to the shareholders of TOMCO, the stake of Unilever in HLL was diluted, suggesting that the objectives of merger did not include an enhancing of the shareholding of the controlling interest in the acquiring firm. However, in order to ensure that the status of HLL as a subsidiary of Unilever was not disturbed, HLL allotted preferential shares in the merged firm of Rs.10 each at a premium of Rs. 95 to Unilever. As a result, Unilever retained control of 51 percent of the total shareholding of the merged firm, while Tata Sons which had held a 20 percent stake in TOMCO, found its shareholding reduced to 1 percent. Following this merger HLL also managed to bring five more Tata companies under its fold. Thus the acquiring firm could acquire complementary brands and manufacturing locations through the merger and increase its market share.
Consequences of the merger

The total assets of HLL increased by 11.81 billion in absolute terms over for the period 1989-90 to 1994-95. The gross fixed capital during the same period rose by 3.36 billion. The annual average growth rate of total assets at constant prices stood at 12.04 percent and that of gross fixed capital at 6.44 per cent during period 1989-90 to 1994-95. However, the acquisition contributed just 13.07 percent of the growth in total assets and 19.01 percent of the growth in gross fixed capital during this period (See Appendix-4 to Appendix-7). This suggests that asset expansion was not a major, though a significant explanation for the merger. The major source of finance used by the acquiring firm to increase its total assets during 1989-90 to 1994-95 was borrowing in the form of current liabilities, which contributed 47.62 percent of the total. Internal resources in the form of retained profit were also significant, contributing 25.45 percent (See Appendix-8). The firm mobilised only 19.18 percent share of resources from the capital market. The major part of the finance (i.e., 14.10 percent) from the capital market was raised through fresh capital.

However, an analysis of the market share in the major products of the acquiring company before and after merger showed that, in the case of soaps and detergents, which was the principal product of the acquired company, HLL's share rose from 28 percent in 1990-91 to 40.4 percent in 1994-95, strengthening it position as the largest producer of that range of products. In dental hygiene products, the market share of the company rose from 10.3 to 22 percent of the total, making HLL the second largest producer. HLL also increased its share of the market for vanaspati
by merging with TOMCO, from 1.5 per cent to 4.8 per cent, which took its rank in the industry from the 14th to the third largest producer.

**The Benefits of Market Dominance: The Case of Detergents**

The soap and detergents industry is a high volume low margin business. It is a mature industry and growing at the average rate of around six percent per annum. According to the Indian Soaps and Toileteries Maker’s Association, the industry is expected to increase its rate of growth to around 7 to 8 percent by year 2000. The per capita consumption of detergents in India is only 1.6 kgs per annum compared to 2.2 kgs in Malaysia, 15.5 kgs in Western Europe, and 18.5 kgs in Australia. The industry expects a high rate of growth with a marginal reduction in the duty on soaps and detergents. The demand for fabric wash products, comprising of synthetic detergents and washing soaps, is expected to grow from about 2.2 million tonnes in 1990 to 4.4 million tonnes in 2000 (Gopalakrishnan & Mubeen Rafat, 1997).

Laundry and toilet soaps are two segments of the soap industry. Laundry soap production was reserved for the small scale sector for many years. However some production is also in the large scale sector. Out of the total of 7.5 lakh tonnes of laundry soap produced in 1995-96, 7 lakhs tonnes was accounted for by a number of regionally distributed companies in the small scale sector. The balance 0.5 lakh tonnes was manufactured by the major players. The increasing costs and restricted

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1 Reported in Business Line, Madras, dated 13/7/97.
availability of necessary oils and fats has, however, retarded production and growth of the laundry soap segment. The availability of synthetic detergents, its increasing popularity and the shifting of the production activities from the laundry soap segment to detergent bars and powders are the other factors which contributed to the stagnation of the laundry soap segment. HLL's merger with TOMCO strengthens its position in the more dynamic segment of the detergents industry, viz., synthetic detergents.

The total production of synthetic detergents including powders and bars in 1996 was 2.2 million tonnes. Although the small scale sector had entered the detergents segment of the market in the early eighties, the market is still dominated by the large scale soap manufacturing giants. The small scale sector produced around 0.60 million tonnes which accounted for nearly 30 percent of total synthetic detergent production. The rest of the production came from the organised sector. Nirma produced 0.70 million tonnes, making it the largest manufacturer, followed by HLL. Earlier, the detergent segment was dominated by five companies - HLL, TOMCO, Nirma, Godrej Soaps, and P&G. HLL's merger with TOMCO in 1993 created the single largest entity in terms of market share. In fact, HLL gained strategically in all the segments of the detergents market by taking over TOMCO. The leaders in the lower end of the detergents market are now Nirma and HLL. The upper end of the market is dominated by Ariel and Surf Ultra.

Thus, it is clear that HLL was able to strengthen its oligopolistic position substantially in a few areas by acquiring a firm which at the time of merger was
faced with financial difficulties. The profit margin and the rate of return of the acquiring firm was higher than that of the acquired firm before merger and these ratios of the acquiring firm rose after the merger. As a result, even though TOMCO was not financially sound at the time of merger, with a leverage ratio of the acquired firm much higher than that of HLL, this ratio for the merged firm showed a declining trend after merger (See Table 6.1, Table 6.2 and Table 6.3).

The financial weakness of the acquired firm at the time of merger meant that the market price of the shares of the acquiring firm was almost six times higher than the market price of the shares of the acquired firm, influencing the exchange ratio in favour of the former. While comparing the total value of shares of the shareholder's of the acquired firm before and after merger, we found that this had decreased after merger despite a rise in the value of their individual shares after merger. This was due to a sharp decline in the number of shares of the acquired firm after merger at the exchange ratio given by the amalgamation scheme. The dividend per share 2 (refer Table 5.11 to Table 5.14) at market prices of the acquired firm decreased after merger. Therefore it is evident that the shareholder's of the acquired firm did not reap financial benefit either in the form of capital gains or in the form of a rate of return through this merger.

**Merger and corporate strategy**

This lucrative merger by Hindustan Lever in the 1990s is in keeping with its

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2 The price earning ratio, dividend per share, total value of shares and the total income earned by the share holders are given in chapter 5.
traditional corporate strategy of using acquisitions to grow in existing markets and in new markets. Hindustan Lever is the Indian affiliate of the Anglo-Dutch conglomerate, Unilever. The parent company Unilever was formed in 1929 and had been engaged in the production of margarine, soaps, detergents and other consumer products. It had over time grown to become one of the top multinationals in the world. Lever Brothers (later Unilever), which was the British branch of the company, entered the business of exporting soap to India in the last decades of the 19th century. Lever's registered its Indian trade business as Lever Brothers India Ltd in 1913. It then took over William Gossage and Sons (India) Pvt. Ltd and Joseph Crossfield & Sons (India) Pvt. Ltd and grew to control almost the entire trade of soap import to India. Later the company chose to establish production capacity in India itself to service its local market. It acquired North West Soap Factory, which was producing low quality soap as compared to the imported lever soap, from the then owner Boulton Bank, during the early twenties. A new factory was commissioned in 1934 at Sewree (Bombay) by merging the above three companies on the basis of 60 percent Indian share capital and involving Indians in the management (Lieten, 1987, p.108). The company controlled more than half of the soap market in India by the end of the second world war. Indigenous entrepreneurs like Godrej and Tata started a movement against the continuing presence of Levers in the Indian market, although the movement was rendered ineffective when HLL reacted by cutting the prices of their product. Unilever also started another subsidiary namely Hindustan Vanaspati Manufacturing Company Ltd. Two separate production branches of Unilever, LB and HVM, together with United Traders Ltd, a trading company, were integrated at
the management level in 1944. In 1956 these three subsidiary companies amalgamated into one public company by offering 10 percent equity shares to the Indian public and entered into a new product line, i.e., synthetic detergents. HLL once again diluted its controlling stake in 1965 by entering into diversified product lines of foodstuffs, particularly cattle food, milk products, dehydrated peas and onions and cotton seeds processing. In 1969 it started production of the Hima range of food products, luxury toilet soaps, personal products, talcum powder and Signal tooth paste.

In 1977, HLL diluted its foreign equity participation to 65.5 percent due to the pressure of restrictions imposed under FERA. However, Unilever's paid-up capital in HLL had increased from Rs.799.64 lakhs in 1965 to Rs.1153.45 lakhs in 1977. Further expansion of HLL took place with the commissioning of the Taloja factory for the production of the fine chemicals in 1979. The last phase of dilution took place in 1980 when the foreign shareholding was brought down to 51 percent. In 1983, it transferred a number of food items to Lipton India due to the constant pressure which price regulation exerted on profitability. Higher profits were directly more beneficial to Unilever in the case of HLL than in the case of Lipton in which it had only a 40 percent shareholding interest. However the grouping of all the food commodity business under Lipton would have allowed HLL to evolve a new corporate image, concentrating on basic chemicals, agro-chemicals and other relatively high technology areas. Although the MRTP act did not allow HLL to expand its capacity in production lines like soap and glycerine, in which it had a
substantial market share, it managed to increase its monopoly position by making use of a system of subcontracting to smaller producers, by entering into the laundry soap market as toilet soap and also by producing more than its licensed capacity (Lieten, 1987, p.124). HLL, around this time almost had 500 companies in India which it had built through mergers, acquisitions and reorganisation (Kaushal, 1995, p.79).

HLL had also acquired number of small scale units through the BIFR before the implementation of new industrial policy in 1991. It also promoted a number of small units to manufacture products reserved for small scale sector. Many of these small scale units, like Stephan Chemicals were expanded to produce low priced detergents positioned against NIRMA, which had become the largest selling brand of detergent in India. In 1983 HLL takeover Stephan Chemicals Ltd on lease for five years as it was running at a loss. In 1985, HLL applied for substantial expansion of its synthetic detergents and toilet soaps capacity at the Stephan Chemicals Ltd, plant, and also acquired 51% equity shares in Stephan Chemicals Ltd.

The mergers and acquisitions drive did not stop with the principal business areas of HLL. Relish Foods Pvt.Ltd was a small scale unit engaged in the activities of processing and exporting marine products. It had experience in the trading of shrimps and prawns through third party units. M/s. Relish Foods was also registered with the Marine Products Exports Development Authority for processing and exporting marine products. In 1986, the central government had issued orders against a proposal for the amalgamation of the company made by HLL. Objections were
received from M/s. Tamil Nadu Industrial Investment Corporation Ltd on the grounds that out of the loan of 10 lakhs granted by TIICL, an amount of Rs. 4.43 lakhs together with interest was still due from Relish Foods Ltd. The proposed arrangement could take effect only after obtaining permission of TIICL. However, the seventh five year plan had identified marine products as a major thrust area to earn valuable foreign exchange for the country. As a result, the proposed leased arrangement with HLL was considered in the interest of the nation as the entire capacity was to be used for exports.

In 1986, HLL took over two garments and stitching factories, Sarif Garments, and Ganesh Garments in order to produce for exports. It also took over another garment stitching factory of Anand Apparels on lease. In 1988 it took over the detergent unit of Union Home Products on lease-cum-purchase basis. It also took over Sivalik Cellulose Ltd., which was engaged in the activities of processing and packaging of toilet soaps, on lease in 1990.

HLL acquired Pond’s India Ltd at an exchange ratio of 3 shares of HLL for every 4 shares of Pond’s since personal care products provide high volumes as well as high margins. Personal care products account for 55 percent of Pond’s turnover against 11 percent for HLL. Thus this merger helped HLL to increase its market share although it had a presence before this merger. Lakme Ltd was divested of its cosmetics portfolio following the sale of its 50 percent stake in Lakme Lever Ltd to

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3 Reported in Business Standard, New Delhi, dated 23/2/98; and Business Line, Madras, dated 12/5/98.
HLL along with its brand\(^4\). Lakme received Rs 200 crore from Lever for the sale of the brands, trademarks, and its 50 percent stake in Lakme-Lever.

Consolidation of the operations of Unilever food companies in India has also been taking place since early nineties in order to build its base in the food industry. This transformation is only in line with Unilever's business worldwide in which food contributes 52 percent to sales\(^5\). The first step was taken in 1992 when plantation companies Doom Dooma Ltd and Tea Estates Ltd in each of which Unilever had a 74 percent holding merged with Brook Bond. This has raised Unilever's equity holdings in Brook Bond to 49.9 percent. Later Unilever increased its stake in BBIL to 51 percent. Brook Bond further strengthened its food foundation by acquiring Kothari General Foods with its instant coffee plant; jam and sauce business of Kissan products Ltd from the UB group; and ice cream business of Cadbury's Dollops. The two Unilever subsidiaries of Brook Bond India Ltd and Lipton India Ltd merged together to form Brook Bond India Ltd. Thus BBLL was the leading player in packaged tea and processed foods till it merged with HLL\(^6\). The tea business of the company registred a growth more than the market growth. Now HLL has emerged as the largest tea business in the world\(^7\). HLL makes frozen desserts out of vegetable fat at its Naship plant in Maharashtra. It also sources dairy-based ice creams from Kwality and markets it under the brand name, Kwality Walls. Now it is planning to make substantial investments in fresh ice cream capacity and for setting up a cold storage facility.
chain since the reservation of this business was removed from the small scale sector in the budget 1997-98. It would also induct new technology in the distribution and sale of ice cream. Although Amul was a strong competitor in this segment, the company expects the expansion of market with competition to accommodate the presence of HLL. In 1996, it launched the Kissan Annapurna range of basic foods, salt and wheat flour in the country. In 1997 it has also chalked out a foods strategy which seeks to develop its basic foods range in to mega brands, and then build on them to develop more value added stuff.

This experience should make it clear that HLL is a classic case of a company which uses M&A as a major instrument of growth and consolidation. The HLL-TOMCO merger was merely one instance of such mergers and acquisitions resorted to in HLL's drive towards oligopolistic dominance. Liberalisation only facilitates the pursuit of this core corporate strategy.

CASE 2: ABB LTD WITH FLAKT INDIA LTD

In recent years, cross-border mergers have increased substantially in the West with large transnational groups, whose controlling blocks often originate in different nations, merging to meet new market developments and competitive threats. Such firms often have separate subsidiaries in individual countries, so that the merger of the parent companies necessitates a restructuring of their worldwide operations, including the mergers of third country subsidiaries. India having been a site for

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8 Reported in Business Line, Madras, dated 22/3/98.
transnational investment for a long period of time has been affected by such developments. An instance of a merger necessitated by the worldwide restructuring of the production operations of a new transnational combine is the merger of ABB LTD and Flakt India. At the time of their merger in 1993-94, both firms belonged to the same business group. In that year, Flakt India was acquired by ABB at an exchange ratio of 1:0.5. ABB group, Switzerland controlled 51 percent of the total shareholdings of ABB Ltd. Similarly 51 percent of Flakt India was owned by Flakt AB, which was a fully owned subsidiary of ABB. As stated in the scheme of amalgamation, the reason for the merger was the need to diversify their production, realise better economies of scale, increase production, integrate marketing approach and strategic alliances. ABB is a major player in the power plants business, largely as a turnkey supplier. It is a $30 billion global company in the field of power generation, transmission and distribution, and in the industrial, environmental and transportation markets. It has substantial experience in turning around sick companies with large inventories, a surplus workforce, outdated equipment and low productivity levels. It has in the past acquired 50 such companies in Eastern Europe. In 1995, this group had an annual worldwide sales of around $30 billion with operations in 1300 companies spread over 140 countries. In India, the 435-MW gas-based combined-cycle power plant at Rajasthan, and the 1,000-MW super thermal plant in Orissa, both NTPC projects, were set up by ABB in the 80’s.

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9 Reported in Asia Age, New Delhi, dated 23/2/95.
In 1988, BBC Brown Boveri Ltd, Switzerland, and its group of companies worldwide on the one hand, and Asea AB, Sweden, and its group of companies worldwide merged their electro-technical operations and formed a new company, Asea Brown Boveri Ltd. Pursuant to this world wide amalgamation, Asia Ltd, a small (750 employees) and aggressive bid-player in the power sector merged with its large (3,500 employees) and stodgy competitor Hindusthan Brown Boveri in 1989 and then changed to Asea Brown Boveri Ltd.

A job evaluation exercise was also conducted between October 1989 and March 1990, which cut hierarchies in ABB Ltd from nine levels to four and created a growth-hungry company. Within three years the company cut down its manpower and rationalised its operations in order to compete with Germany's Siemens; the Anglo-French, GEC Alsthom; Japan's Mitsubishi and America's GE. It set up a boiler factory and a turbine plant and enhanced the range of transmission products, as well as introduced new transmission products, circuit breakers and pollution control equipment. It became a local market leader in three industrial product segments: induction furnaces (35 percent market share), circuit breakers (40 percent), and power line carrier communication systems (60 percent). It strengthened its power generation equipment capacity by entering in to the manufacturer of boilers through takeovers. It took over Culcutta-based sick boiler manufacturer ACC Babcock Limited (ABL) with 500 employees and is seeking to modernise and make it a world-class boiler company.\(^\text{10}\) It also planned to set up power generating units in

\(^{10}\) Reported in Business Standard, New Delhi, dated 17/1/95.
the country by organising a consortia of project promoters and taking equity positions in the promoting company. Although the company is known as a power equipment manufacturer, the major contribution currently comes from equipment manufacture in four other segments: power transmission, power distribution, industry and transport. Transmission systems contribute nearly 40 percent of the company's turnover in 1992 and it was further expected to expand both by acquisition and entering new business. It has bid for a 35 percent stake in the Karnataka State Government Electricity Factory which makes transformers and motors. ABB is also trying to establish its base in the high voltage direct current business (HVDC) which was rapidly growing in India. ABB was internationally known for developing the world's most advanced HVDC transmission system and set up the first HVDC link in the world in 1954, which helps to reduce power loss in transmission, improve system stability and facilitate the interconnection of different types of networks like the AC and DC lines. It has 36 different HVDC projects in the world transferring an estimated 30,000 MW of power and has close to 70 percent of the world market share of HVDC systems. In India BHEL was manufacturing HVDC systems under licence from ABB Sweden. The Rihand Delhi HVDC link and NTPC's Vindhyachal HVDC station in Himachal Pradesh were built using ABB technology. It already has an equity stake in three of the 'fast track' power projects including the A.P. project of GVK industries, the Neyveli project being set up by ST power systems and a project in MP along with the Soros Fund. The parent company merged its

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11 Reported in Economic Times, New Delhi, dated 21/2/96 and 29/2/96.
12 Reported in Hindu, Madras, dated 20/1/95.
transmission and distribution business segment in the late 80s. A similar phenomena was observed even in India when ABB Ltd merged with SAE which was the leader in the transmission tower business, with a 35 percent market share.

As part of its international strategy of becoming a major player in chosen fields, Flakt AB which held 51 percent of the share capital of Flakt India as on 15/11/1993 became a fully owned subsidiary of Asea Brown Boveri Ltd, the holding company of ABB. The merger of ABB Ltd and Flakt India was a fall-out of the restructuring operations that followed that international merger. In 1994, Flakt India, engaged in the manufacture of air pollution control equipment which was mainly used by the cement, petrochemical, chemical industries and thermal power stations, merged with ABB Ltd. In the process in the automation business of the industry segment, ABB became a leader in pulp and paper, cement, and caustic soda sectors. According to the ABB’s own projections, this industry segment is the fastest growing business segment. Another promising area is automotive and control systems, which was previously with Taylor India, an associate company, which has also now been shifted to ABB. ABB is also an important supplier of locomotives and other equipment to the railway and the first tender was floated in 1987. There is an agreement between ABB and the Indian government for the transfer of technology, to manufacture 6,000 horse power locomotives in India towards the latter part of this decade. Hitachi and Sumitomo are the rivals in this segment. The new joint venture company i.e Adtranz, India was formed in 1996 with both companies having an equal stake in order to handle all railway activities of ABB and Germany’s Daimler-
As a result of the replication of its international strategy in India, ABB, which was considered a mid-sized corporation with a turnover of Rs.326 crore in 1992, expects to turn itself into a regional leader in the field of power generation and transmission equipment and services. It has planned to invest an additional $700 million by 2002 in India and this will be directed towards consolidation and expansion of existing operations, take-overs, equity participation in power projects, exploration of hydrocarbons and financial services designed to promote companies in the manufacturing business. This Swiss-Swedish conglomerate with a global turnover exceeding $30 billion wants to increase the turnover of its Indian group of companies from the present $1 billion to $3 billion by the turn of the century with the ultimate objective of becoming India’s largest private-owned engineering house with its exports contributing to 20-30 percent of turnover. It plans to invest Rs 5 crore to produce fibre optic and micro-wave-based transmission systems and another Rs 60 crore in a new plant to manufacture 350 HP electric motors for the textiles and mining industry. ABB is also shifting resources to a large extent to Asia-Pacific from Europe and the US since 90s. It was estimated that the Asia-Pacific which accounts for 20-25 percent of the capacity of the industry as a whole during the 1990s would grow to contribute 40 percent in 2000. While 62,000 jobs were cut in the US and Western Europe, about 57,000 new jobs were added in the new and emerging

14 Reported in Indian Express, New Delhi, dated 20/1/95.
15 Reported in Business Line, Madras, dated 29/9/95.
markets in Asia and Eastern Europe in order to stay competitive and in tune with the changing environment. The region contributed about 18 percent of ABB’s orders at about $6.3 billions.\(^{16}\)

During 1989-90 to 1994-95, the annual average growth of total assets of ABB stood at 17.85 percent and the growth of gross fixed capital at 16.09 per cent. Although, total assets have increased by Rs.5.67 billion, the acquisition of Flakt India contributed only 12.23 percent. In the case of gross fixed capital, the acquisition contributed only 7.19 percent. The largest share of resources mobilised by the company during this period is through borrowing in the form of current liabilities (61.34 percent). The company also garnered internal sources in the form of retained profit (23.24 percent) during 1989-90 to 1994-95 (see Appendix-4 to Appendix-8). The market share of “apparatus for making & breaking circuits” was increased to 10 percent during 1994-95 from 8.3 percent during the year 1990-91 and maintained the same position.

An examination of gearing ratios indicates that the acquired company was financially more sound than the acquiring company and the capital structure of the acquiring firm improved in the post-merger period. This would have helped the company to borrow more funds to finance its expansion plans (see Table 6.1, Table 6.2 and Table 6.3). The price earning ratio of the acquired firm before merger was higher than that of the acquiring firm. The total income earned by the shareholder’s of the acquired firm did not increase after merger. However the marketability of the

\(^{16}\) Reported in Business Line, Madras, dated 28/2/98.
shares of the acquired firm and the total value of the shares after merger was higher than the period before merger since the market price of the shares of the acquiring firm was higher than that of the acquired firm (Refer Table 5.11 to Table 5.14 in chapter 5).

**CASE 3: GODREJ SOAPS WITH GUJARAT GODREJ INNOVATIVE CHEMICALS**

Liberalisation would see not only big foreign firms acquiring domestic firms in India but also Indian firms combining together to face the new environment. In an unusual case of reverse merger, Gujarat Godrej Innovative Chemicals Ltd, which was a loss making company, acquired the profit making company, Godrej Soaps Ltd during the year 1994-95 at an exchange ratio of 1:1 and changed its name to Godrej Soaps Ltd after the merger. The acquiring company was promoted by the Godrej group and Gujarat Industrial Investment Corporation. As per the scheme of amalgamation, the acquiring firm was expected to tap local as well as international synergy arising from the financial strength of Godrej Soaps Ltd and export orientation of Gujarat-Godrej Innovative Chemicals Ltd. (GGCIL), and synergies arising from the integration of operations and the reduction in duplicative costs. The acquiring and the acquired company were not only part of the same management but the former used to supply the raw materials consumed by the acquired company before merger. Thus this was an instance of translating an existing forward integration between separate legal entities into a single integrated operation. The merger was also expected to provide better access to the international market through Godrej International Ltd which was a parent company of Godrej Soaps Ltd.
An analysis of financial indicators suggests that the acquisition was part of a strategy by Godrej to reduce its tax liabilities as well as to restructure its soap manufacturing business based on investment financed by borrowing. The acquiring company GGCIL was promoted by Godrej & Boyce Manufacturing Co Ltd and Guajrat Industrial Investment Corporation Ltd in 1989-90 by investing Rs 500 lakhs in 50 lakh equity shares of Rs 10 in order to manufacture, import and export, oleochemicals, petrochemicals, synthetic detergents, toilet soaps and vegetable oils. The merger of the profit making company (Godrej Soaps Ltd) with the loss-making GGCIL in 1994/95, facilitated a tax saving for Godrej Soaps Ltd. Godrej Soaps' tax provision before merger, for the year 1993-94, was 5.75 crore. This fell drastically to Rs.1.05 crore during 1994-95, immediately after the merger. The tax provision for 1995-96 fell even further to Rs.0.11 crore as compared with the previous year.

Although the sales of GGCIL, now known as Godrej Soaps Ltd, registered a high rate of growth immediately after merger, its net profit showed a declining trend due to a sharp substantial increase in interest and other financial charges. This was due to a significant increase in the debt incurred by the company. There are various factors which contributed to the increase in the indebtedness of the company. To start with, debt rose because it helped finance the cash requirement associated with a higher level of operations. Secondly, as part of a restructuring strategy the company announced a voluntary retirement scheme, which was availed of by 552 employees who were paid a total compensation of Rs.22.75 crores. Interestingly, the borrowing of the acquiring company (GGICL) from the lending institutions was at a relatively
high rate of interest. This affected the financial performance of the merged firm. The financial performance of the acquired firm was better than that of the acquiring firm before the merger, and it also recorded a higher price-earnings ratio (see Table 6.1, Table 6.2 and Table 6.3).

Expansion was also financed by increasing the equity capital of the firm. The equity of the new company was increased through a 1:2 bonus issue by capitalisation of reserves, which has resulted in a drop in earnings per share to Rs. 7.2 in 1995-96 from 8.04 in 1994-95. It also issued preference share capital during 1995-96. Subsequent to merger, the price-earnings ratio of the merged firm rose sharply, whereas the earning per share registered only a marginal increase. This was because high interest debt adversely affected the financial viability of the merged firm, though the acquiring firm was merged with a financially sound firm.

The role of debt in restructuring is illustrated by the role of debt in financing asset growth. The annual average rate of growth of total assets of GGCIL was 18.51 percent during 1989-90 to 1994-95, and that of gross fixed capital was 23.88 percent (see Appendix-4 to Appendix-8). The acquisition accounted for 75.32 percent of the growth of total assets and 71.62 percent of the growth in gross fixed capital. To the extent that assets were expanded beyond that resulting from the acquisition, borrowing financed as much as 51.25 per cent of the difference. The bonus issue which capitalised reserves helped mobilise another 27 percent of its total resources. The income earned by the shareholder's of the acquired firm through the merger process was slightly higher in the period after merger. However, the marketability of
the shares and the total value of shares of acquired firm had fallen after merger as compared with the period before merger (see Table 5.11 to Table 5.14).

Restructuring and Corporate Strategy

The restructuring through merger initiated by the company is one more step in Godrej's strategy of attempting to survive and grow in a highly competitive market, as its history shows. Godrej Soaps Ltd was incorporated in 1928 to manufacture soaps and perfumery and sell products manufactured by Godrej & Boyce Manufacturing Co. Pvt. Ltd. of the Godrej family. The market for soaps has always been a competitive one. The export potential of the industry is low since it has been dependent on imports for its raw materials for a long period of time. All companies have been looking to expand at the expense of others. Many small players and some big ones like Shaw Wallace have had to exit from the industry. Initially, the government restricted the players' sizes and thereby, competition. Today, capacity limits have gone and HLL operates as a near monopoly with an almost 70 percent share of the market. Godrej has installed soap making capacity of 71,381 tonnes at Mumbai and Malanpur in MP. The capacities of its two key brands Lux and Lifebuoy account for more than Godrej's full capacity. Lever's in-house capacity, apart from contract manufacturing outside, is 1,95,283 tonnes.

17 Reported in Business Standard, New Delhi, dated 18/9/96.
Faced with severe competition from an international brand, Godrej Soaps arrived at a now famous strategic alliance with P&G in 1993 when it allied with its competitor to form the new company P&G Godrej. The partnership transferred Godrej’s marketing and distribution business and its toilet soap sales to P&G Godrej. Godrej’s detergent business and scouring powder markets were sold to P&G India. Godrej soap was to manufacture toilet soaps for P&G Godrej and P&G India. In the more recent process of restructuring triggered by greater liberalisation, Godrej Soaps broke its marketing partnership with Procter and Gamble in 1996. Godrej decided to do it alone, regaining control over its former soap brands by taking over marketing, sales and distribution. However it was to continue to manufacture Camay for P&G for another two years, while its detergents Trilo, Key Biz and Ezee continued with P&G.

Although Godrej Soaps launched Cinthol soap in India in the year 1952, it now controls only 9 percent market share in the Indian soap market. The thrust of its current strategy is to refocus and relaunch some of its brands like Cinthol and Ganga while pulling out its brands that have done badly in the market. Growth in the soap category is slow - 10-15 percent by volume - and the product is characterised by high market penetration. It forms only 20-25 percent of Godrej Soap’s turnover and 10-12 percent of the overall Godrej group turnover. As a result, through restructuring, household insecticides is going to be a big focus for Godrej soaps. The production of this item is growing at 30 percent and penetration levels are only at 25 percent. Exports of insecticide mats to South East Asia, Africa and West Asia were to begin
by March 1998\textsuperscript{18}. Consumers in the personal care market have shown an increasing awareness and demand for new products such as deodorants. Therefore the company decided to enter the lower end of the market for this new product. It is also planning to strengthen its hold on the edible oil business and to enter the colour cosmetics business in a joint venture with a foreign manufacturer. Thus, a continuous process of restructuring has been part of the company's strategy and the merger under discussion, which exploits financial benefits in the form of tax advantages and the capitalisation of reserves to finance expansion, is one element of that overall corporate strategy.

**CASE 4: NOCIL WITH POLYOLEFIN LTD**

Another instance of a related merger aimed at restructuring operations is that involving Nocil. Nocil acquired its subsidiary Polyolefins which produces petrochemical products during 1993-94 at an exchange ratio of 1:1. The shares (31 percent) controlled by the acquiring firm in the acquired firm were cancelled in accordance with the scheme. Prior to merger, the acquired company obtained 40 percent of the main raw material consumed by it, viz., ethylene required to produce high density polyethylene from the acquiring company. As per the scheme of amalgamation, it is expected to help exploit economies of scale by cutting down administrative and managerial costs, improving capital structure and facilitating

\textsuperscript{18} Reported in Business Standard, New Delhi, dated 23/7/97.
operational flexibility in the marketing of its products.

The contribution of the merger to the size of the merged company is obvious. The acquisition contributed 44.81 percent of the growth in total assets of Nocil, which increased by Rs.7.64 billion or an annual average rate of 13.80 percent during 1989-90 to 1994-95. The increase in size also appears to have facilitated resource mobilisation to finance expansion. The largest share of resources mobilised by the company during 1989-90 to 1994-95 came from borrowing (i.e., 35.91%) . It mobilised another 21.87 percent of its total resources through the capital market (see Appendix-4 to Appendix-8).

NOCIL was the first company to set up a naphtha based cracker in India. It was promoted by Arvind Mafatlal Group in 1961 which operated a small, integrated petrochemicals plant with production capacity of around 0.1 million tonnes per annum. The company in which the Mafatlal's held 13.6 percent equity and the financial institutions 33.33 percent entered into a technical collaboration with the Royal Dutch/Shell group of companies and the Universal Oil Products Company USA, to set up an integrated plant for petrochemical products in 1964. The major product lines of Nocil are ethylene oxide, ethylene glycol, HDPE and PVC. In addition to own production, it sources about 20-22 thousand tpa of ethylene from IPCL through a direct pipeline in order to manufacture ethylene glycol, HDPE, etc. The Mafatlals were among the five largest business houses in the country all through the sixties and seventies. Nocil also has a minor interest in the rubber chemicals and trading business which accounted for 12 percent of turnover during
1994-95. It is one of the three players in the rubber chemicals sector in India having 30-32 percent of the market share. It also has manufacturing facilities for speciality pesticides such as Monocrop and several grades of solvent/ alcohols utilizing benzene produced in its plant. It exports PVC resins, rubber chemicals, ethyl Hexanol etc. It has preliminary tie up for technology from KTI of Holland and Technip of France for cracker; Himont and Technimont of Italy for polypropylene and polyethylene and Buss of Switzerland for its ethoxylates.

NOCIL promoted Polyolefins Industries Ltd which operated in product lines similar to the parent company and consumed 50 percent of the ethylene production of NOCIL. This sister company had been set up by investing 31 percent of the equity in collaboration with Farbwerke, Hoechst Germany which held another 31 percent of PIL's equity.

The petrochemical industry is capital and technology intensive. The minimum economic size of an integrated plant is around 1mn tpa of end product which entails an investment of Rs. 100bn. This industry was dominated by the state owned IPCL till the early 1990s and NOCIL was the only other player having an integrated complex. Subsequently, Reliance entered the industry with much larger capacities and emerged as a major player with large downstream and upstream facilities. The commencement of new projects by Reliance with large capacity facilitated by the new liberalised industrial policy intensified competition in this industry, making restucturing inevitable. From the point of view of the Mafatlal Group not only were the individual capacities it had set up relatively uneconomic,
but they were dispersed in two different units. In order to compete with the new players which emerged in the 1990s, NOCIL planned to raise its equity with the intention of partly-funding its Rs 6,000-crore expansion plan to replace its 26 year old naphtha cracker with a new 3,00,000-tonne plant. The Royal Dutch/Shell group decided to withdraw from the management and withdrew its 33 percent equity ownership of the company in 1992, when its proposal to hike its equity stake to a majority 51 percent was not accepted by the Mafatlal group. Thus the entire share holding of Royal Dutch was bought by Mafatlal in 1993. It also acquired PIL in 1993 in order to make the company more financially strong. It issued 1.3 million equity shares of Rs 100 each, to PIL's shareholder pursuant to the 1:1 merger. Thus, the consolidated company after merger will have a net worth of Rs 278 crore (Rs 55cr share capital, plus Rs 233 crore reserves and surplus) and Rs 394 crore gross block which would help the company in accessing higher borrowings. This merger was also aimed at preventing outside bidders from acquiring the stake of Shell/Royal Dutch in Nocil.

Thus this instance of merger is a typical instance of one in which groups which had created legally independent companies in the past for exploiting specific advantages, such as access to new collaborators, for example, had to restructure through merger in the face of competition. However, the company is yet to capitalise fully the advantages from its restructuring. The rate of return of the acquiring firm was higher than that of the acquired firm before merger, but this ratio decreased after merger. The profit margin was slightly better than the acquiring firm before merger.
and this ratio of the acquiring firm has increased after merger (see Table 6.1, Table 6.2 and Table 6.3). The dividend received by the shareholders of the acquired firm was higher than the acquiring firm before the period of merger. However, the shareholders of the acquired firm earned relatively higher dividend in the post merger period, but the marketability of their shares and the total value of shares has decreased after merger (refer Table 5.11 to Table 5.14).

CASE 5: RELIANCE INDUSTRIES LTD WITH RELIANCE PETROCHEMICALS LTD

At the end of March 1992, the Ambani family controlled approximately 26 per cent of the issued equity shares of its flagship company Reliance Industries Ltd. It had earlier, in 1988, created Reliance Petrochemicals Ltd as a separate legal entity, in keeping with the strategy adopted by most business groups, given the environment of intervention at that time. RPL was initially a wholly owned subsidiary of RIL, but the latter's equity holding was diluted in stages, through the conversion of convertible debentures issued to mobilise additional resources, to 21 per cent. In January 1992, RIL acquired a 100 per cent stake in Redwood, which in turn acquired REPL. Subsequently RIL transferred its 21 per cent stake in RPL to Reliance Enterprises Pvt. Ltd. At the end of March 1992 REPL, held 21 percent of the shares in RPL. RIL acquired RPL thereafter. The Ambani family controlled around 24 percent of the shares of the combined entity, immediately after the merger. Financial institutions owned 18 percent of the equity shares. Thus the merger was a reversal of
a conscious strategy of maintaining RPL as an independent legal entity.

An increase in the size of the flagship firm was indeed one of the motives behind the merger, especially given Reliance's penchant for resorting to capital markets to mobilise resources for growth. The annual average rate of growth of the total assets of Reliance Industries during 1989-90 to 1994-95 stood at 22.59 percent and that of gross fixed capital at 19.02 percent. The acquisition accounted for 25.85 percent of the growth of total assets which showed an increase of Rs.89.76 billion between 1989-90 and 1994-95. The capital market was a major source of finance, accounting for as much as 54.53 per cent of the total. Much of these resources accrued to the firm in the form of share premium (see Appendix-4 to Appendix-8).

The other consequence of the merger and possibly one of motives for merger from the point of view of the Ambani family, was a substantial increase in the net worth of the controlling interest. As shareholders of RPL, the Ambani's registered an immediate capital gain through this merger process. The market value of the shares of the acquired firm increased more than ten times through this merger. The total income earned by the shareholders of the acquired firm also increased after merger (see Table 5.11 to Table 5.14). Although the profit margin of the acquiring firm improved after merger, the rate of return (i.e gross profit/TCE) showed a declining trend after merger (see Table 6.1, Table 6.2 and Table 6.3).

Finally, there are minor advantages of the merger as well. Mergers are often justified on the ground of savings in costs. In the West, this would take the form of rationalisation of manpower and eliminating some redundancies at the middle
management level. But in India there is another aspect of savings in costs. Transactions between units within the group post-merger, would now be regarded as inter-division transfers rather than as outright sales. For instance, Reliance produces the raw material for manufacture of polyester staple fibre. The output is consumed by a unit which manufactures polyester yarn. The yarn in turn is consumed by units which manufactures textiles. The transfer would have attracted sales tax at each point of transfer if each of these units had been a distinct corporate entity. Policy compulsions in the past had forced entrepreneurs to mask the identity of common management control even at the cost of a higher sales tax burden. According to the promoters view, mergers among group companies are a logical outcome in the context of maximising shareholder value.

The latter point should however not be overstressed Reliance did not evolve in its present form from a merger of different units manufacturing different upstream and downstream products. The Reliance Group was founded by Dhirubai Ambani in 1966, with the incorporation of Reliance Textile Industries Pvt. Ltd in Maharashtra and the establishment of a synthetic fabrics unit in the same year. Although its initial business was the manufacture of textiles, the company started manufacturing Polyester Filament Yarn in 1982 with financial and technical collaboration from E.I. Du Pont De Nemours & Co USA. The textile division, including preparatory, weaving and processing sections was modernised, in 1984. The company also diversified its activities in the mid-eighties. As a measure of diversification, the

company set up a project for the manufacture of linear alkyl benzene (LAB) in technical collaboration with UOP processes International Inc, USA. In 1985, it decided to manufacture High Density Polythylene and Polyvinyl Chloride. Technical agreements were signed with Du Pont for HDPE and B.F Goodrich & Co for PVC. It also decided to manufacture Mono Ethylene Glycol (MEG), a basic raw material required for the polyester industry in collaboration with Scientific Design Company, New York. It started manufacturing polyester staple fibre in 1986 in technical collaboration with F.I.Du Pont De Nemours & Co USA. Reliance Industries was incorporated in 1973 under the name Mynylone Ltd in Karnataka in 1975 and adopted its current name in 1985. It subsequently merged with Reliance Textile Industries Pvt.Ltd.

Thus Reliance integrated vertically from polyester fabrics to fibres and fibre intermediates and then entered into basic petrochemicals. After establishing a strong textiles group in India, the company first integrated upstream into the manufacture of polyester fibres. It bought the very best technology and sized the plants to be more competitive internationally. Later on it entered in to the production of fibre intermediates. It also diversified outside the fibres stream first into LAB and more recently into the thermoplastics field. Reliance Petrochemicals Ltd was established in 1988 to produce these petrochemicals. Its Purified Terephthalic Acid capacity was commissioned in 1988 in technical collaboration with Imperial Chemical industries.

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20 Pure Terephthalic Acid competes with dimethyl terephthalate as an intermediate in the manufacture of polyesters. PTA is now the preferred intermediate and no further DMT capacity is likely to be built.
UK and UOP Processes International Inc; USA.

Reliance has considered mergers and acquisitions as one means to sustain it rapid expansion. It is considering a proposal to finalise an agreement on JK Corporations loss making synthetic fibre division, Orissa Synthetics with a capacity of 35,000 tonne per annum. It will involve an arrangement for conversion and an understanding to takeover the division at a later stage. According to this scheme, Reliance was to provide raw material to Orissa Synthetics which was to be converted to polyester staple fibre for sale in the domestic market. Orissa Synthetics, which was incorporated in the beginning as a joint sector company promoted by Orissa Industrial Development Corporation and the Singhanias in 1986, was losing out due to the presence of Reliance industries, which also began its operations during the same time. It was referred to BIFR in 1990, which suggested that the company go for merger with a profit making group firm without losing full control of Singhanias on the company. Thus the company merged into JK corporation in 1994 although it continued making huge losses.

Reliance had acquired a plant of ICI a few years ago. Reliance group has further consolidated its position in the polyester industry by entering into an alliance with RPG-owned India polyfibres as a co-promoter\(^\text{21}\). India polyfibres has equity capital of Rs 46.45 crore and accumulated losses of Rs 168.54 crore as on March 31, 1997. The total dues to banks and FIs stood at Rs 148 crore. Out of their total equity, institutions hold 17.29 percent of the equity while about 53 percent is held by the

\(^{21}\) Reported in Economic Times, New Delhi, dated 15/1/98.
promoters, the RPG group. Foreign holdings amount to 0.03 percent while the balance 27.72 percent is held by the public. One of the main reasons behind IPL’s bad performance was the aggressive price competition from Reliance, the largest polyster staple fibre maker in the country\textsuperscript{22}. Accordingly, 75 percent of the share capital would be written off and the interest amount on the loans outstanding would be waived. Reliance industries would have to bring in additional funds in the form of equity capital and the same would be used to pay off institutional dues. This would increase the latter’s stake significantly and that of RPG group to almost negligible amount\textsuperscript{23}. The Reliance group plans to bring synergy to IPL’s operations in terms of technology, raw materials, and other resources, besides upgrading the manufacturing facilities. This deal would give RIL a foothold in the northern market\textsuperscript{24}.

CONCLUSION

Our analysis of individual cases of merger indicate that a wide range of motives drive the merger movement - a fact that is partly shrouded when we considered larger samples, in which it is clear that mergers between related companies in order to face up to changes in the environment in the 1990s dominated. We could argue that once this first phase of the post-liberalisation merger movement is over, other firm specific motives and strategic acquisitions by foreign firms seeking a foothold in the Indian market would come to dominate.

\textsuperscript{22} Reported in Economic Times, New Delhi, dated 28/3/98.
\textsuperscript{23} Reported in Business Standard, New Delhi, dated 28/4/98.
\textsuperscript{24} Reported in Indian Express, New Delhi, dated 15/1/98.