Subject Code : 14MBA FM407	**IA Marks : 50**
Subject: Mergers, Acquisitions and Corporate Restructuring	**Exam Hours : 03**
Total Number of Lecture Hours : 56	**Exam Marks : 100**
Practical Component : 01 Hour / Week	**No. of Lecture Hours / Week : 04**

SYLLABUS

Module 1: (8 Hours)

Mergers- types of merger – theories of mergers- operating, financial and managerial synergy of mergers – value creation in horizontal, vertical and conglomerate mergers – internal and external change forces contributing to M & A activities- Impact of M & A on stakeholders.

Module 2: (5 Hours)

M & A – A strategic perspective- industry life cycle and product life cycle analysis in M&A decision, strategic approaches to M&A- SWOT analysis, BCG matrix, Porter's five forces model

Module 3: (9 Hours)

Corporate restructuring – significance - forms of restructuring – joint ventures – sell off and spin off – divestitures – equity carve out – leveraged buy outs (LBO) – management buy outs – master limited partnerships – Limited Liability Partnership (LLP) in India: Nature and incorporation of LLP-De merger- strategic alliance- buyback of shares-employee stock ownership plans (ESOP)

Module 4: (7 Hours)

Merger Process: Dynamics of M&A process - identification of targets – negotiation – closing the deal. Five-stage model – Due diligence – Types - due diligence strategy and process – due diligence challenges.

Process of merger integration – organizational and human aspects – managerial challenges of M & A

Module 5: (12 Hours)

Methods of financing mergers – cash offer, share exchange ratio – mergers as a capital budgeting decision Synergies from M&A: Operating and Financial synergy

Accounting for amalgamation –amalgamation in the nature of merger and amalgamation in the nature of purchase- pooling of interest method, purchase method – procedure laid down under Indian companies act of 1956

Module 6: (7 Hours)

Takeovers, types, takeover strategies, - Takeover defenses – financial defensive measures – methods of resistance – anti-takeover amendments – poison pills

Module 7: (8 Hours)

Legal aspects of Mergers/amalgamations and acquisitions/takeovers- Combination and Competition Act- Competition Commission of India (CCI)- CCI Procedure in Regard to the transactions of Business Relating to combination of Regulations 2011- Scheme of Merger/Amalgamation-essential features of the scheme of amalgamation-Approvals for the scheme-Step wise procedure- Acquisitions/Takeovers- Listing agreement-The SEBI Substantial Acquisition of Shares and Takeover code.

Practical component:

Pick up any latest M&A deal. Generate the details of the deal and then study the deal in the light of the following.

• Nature of the deal: merger, acquisition, or takeover. If it is a merger, what type of merger is it?

• Synergies likely to emerge to the combining and the combined firm(s) from the deal

• The valuation for the merger

• The basis for exchange rate determination

Objectives:

• To facilitate understanding of corporate merger and acquisition activity and restructurings

• To examine the role that M&A plays in the contemporary corporate world, and its use as a strategic tool to provide growth, enhance competitive position, transform a company or industry, and create shareholder value.

• To compare and contrast the various forms of corporate restructuring.

• To provide the student a framework for analyzing transactions including understanding strategic rationale, deal structures, bidding strategies, and the need for a value proposition.

• To assess human and cultural aspects of M&A's.

RECOMMENDED BOOKS:

1. Mergers, Restructuring and Corporate Control, Fred Weston, Kwang S Chung, Susan E Hoag, 4/e, Pearson Education.
2. Corporate Finance-Theory And Practice – Aswath Damodaran – John Wiley & Sons.

3. Takeovers, Restructuring And Corporate Governance, Weston, Mitchell And Mulherin - 4/e, Pearson Education, 2003.
4. Advanced Accounts Vol. 2 – Shukla & Grewal, S.Chand & Sons.
5. Mergers and Acquisitions, Rajinder S. Aurora, Kavita Shetty and Sharad R. Kale, Oxford University Press, 2011.

REFERENCE BOOKS:

1. Value Creation from Mergers And Acquisitions, Sudi Sudarsanam – 1/e, Pearson Education, 2003.
2. Merger Acquisitions & Corporate Restructuring – Chandrashekar Krishna Murthy & Vishwanath. S.R – Sage Publication.
3. Mergers, Ramanujam et al, TMH, 2003.
4. Handbook of International Mergers & Acquisitions, Gerard Picot, Palgrave Publishers Ltd.
5. Mergers, acquisitions and Corporate Restructuring, Nishikant Jha, Himalaya Publishing House, 2011.
6. Corporate Restructuring, Bhagaban Das, Debdas Raskhit and Sathya Swaroop Debasish, Himalaya Publishing, 2009.
7. Business Legislation for Management, M.C. Kuchhal and Vivek Kuchhal, 4/e, Vikas Publishing House, 2013.

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Module 1: (8 Hours)

Mergers- types of merger – theories of mergers- operating, financial and managerial synergy of mergers – value creation in horizontal, vertical and conglomerate mergers – internal and external change forces contributing to M & A activities- Impact of M & A on stakeholders.

Mergers

1. In the pure sense of the term, a merger happens when two firms agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals".
2. A merger refers to the process whereby at least two companies combine to form one single company. Business firms make use of mergers and acquisitions for consolidation of markets as well as for gaining a competitive edge in the industry.

The phrase **mergers and acquisitions** refers to the aspect of corporate strategy, corporate finance and management dealing with the buying, selling and combining of different companies that can aid, finance, or help a growing company in a given industry grow rapidly without having to create another business entity.

- ***Merger*** – Combination and pooling of equals, with newly created firm often taking on a new name
- ***Acquisition*** – One firm, the acquirer, purchases and absorbs operations of another, the acquired
- ***Merger-acquisition strategy***
  - Much-used strategic option
  - Especially suited for situations where alliances do not provide a firm with needed capabilities or cost-reducing opportunities
  - Ownership allows for tightly integrated operations, creating more control and autonomy than alliances

Objectives of Mergers and Acquisitions

- To create a more cost-efficient operation
- To expand a firm’s geographic coverage
- To extend a firm’s business into new product categories or international markets

- To gain quick access to new technologies or competitive capabilities
- To invent a new industry and lead the convergence of industries whose boundaries are blurred by changing technologies and new market opportunities

Mergers - Definition

- Any transaction that forms one economic unit from two / more previous ones.
- It's a combination of two or more companies into a single company where one survive and other lose their corporate existence.
- A/c to Halsubury's Laws of England, *Merger is blending of two or more existing undertakings into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which is to carry on the blended undertaking.*
- The shareholders of two companies deciding to pool the resources of the companies under a common entity to do the business activity is called merger.
- Two companies agree to go forward as a single company rather than separately owned and operated.
- Both companies' stocks are surrendered and new stock is issued in its place.
- Examples of Mergers

- TATA-CORUS-$13 Billion
- Daimler- Benz & Chrysler -> Daimler Chrysler.
- JP Morgan /Chase Manhattan becomes JP Morgan Chase
- Exxon and Mobil becomes Exxon-Mobil

- Sometimes target firms name disappears and combined firms are known by acquired name or sometimes, by a completely new name.

  Ex: Burroughs/ Sperry Rand became Unisys.
- It is also called as Amalgamation.

Categories of Merger

A merger is said to occur when two or more companies combine into one company. Mergers may take any one of the following forms.

- Amalgamation
- Absorption

- Combinations
- Acquisitions
- Takeover
- Demergers

1. Amalgamation

- Ordinarily amalgamation means merger.
- Amalgamation: is used when two or more companies' carries on similar business go into liquidation and a new company is formed to take over their business.
- Ex: the merger of Brooke Bond India Ltd., with Lipton India Ltd., resulted in the formation of a new company Brooke Bond Lipton India Ltd.

2. Absorption

- Absorption is a combination of 2 or more companies into an existing co. All co's except one lose their identity in a merger through absorption.
- Ex: Absorption of Tata Fertilizer Ltd (TFL) by Tata Chemicals LTd (TCL)
- TCL an acquiring co (buyer); survived after merger while TFL an acquired co (a seller) ceased to exist.
- TFL transferred its assets, liabilities and shares to TCL under the scheme of merger.

3. Combinations/ Consolidation

- Consolidation: two or more companies combine to form a new company. In this form of merger all companies are legally dissolved and a new entity is created.
- In a consolidation, the acquired company transfers its assets, liabilities and shares to the new company for cash or exchange of share.
- Ex : Merger or amalgamation of Hindustan Computers Ltd, Hindustan Instruments Ltd, Indian software co Ltd and Indian Reprographics ltd in 1986 to an entirely new co, called HCL ltd.

4. Acquisitions

- Acquisition means acquiring the ownership in the company. When 2 companies become one , but with the name and control of the acquirer, and the control goes automatically into the hands of the acquirer.
- A classic example in this context is the acquisition of TOMCO by HLL.

5. Takeover

- A takeover generally involves the acquisition of a certain stake in the equity capital of a company which enables the acquirer to exercise control over the affairs of the company.

- Takeover implies acquisition of controlling interest in a company by another company. Itdoesn't lead to the dissolution of the company whose shares are being / have been acquired. It simply means a change of controlling interest in a company through the acquisition of its shares by another group.
- Ex: HINDALCO took over INDAL by acquiring a 54% stake in INDAL from its overseas parent, Alcan. However, INDAL was merged into HINDALCO.

6. **Demergers**
   - Demerger or split or division of a company is opposite of mergers and amalgamations
   - Ex: Hero Honda demerged from Honda and became Hero.

Types of merger

- Horizontal Mergers
- Vertical Mergers
- Conglomerate Mergers
- Concentric Mergers
- Circular Combination

1. Horizontal Merger

- This involves two firms operating in the same kind of business activity. Both acquiring and the target company belong to same industry.
- Main purpose is to obtain economies of scale in production by eliminating duplication of facilities and operations.
- This is a combination of two or more firms in similar type of production, distribution or area of business.
- Motives:
- Elimination or reduction in competition
- Putting an end to price cutting
- Economies of scale in production
- Research and development
- Better control over Marketing and management.
- Increase market power
- Ex: combining of book publishers or two mufgco's to gain dominant mkt share. (Mittal's Strategy)
- The acquisition of American Motors by Chrysler in 1987 represents a horizontal combination or merger.
- Bank of Madura was merged with ICICI Bank.

- Horizontal merger increase monopoly power of the combined firm.

2. **Vertical Merger**

- This occurs between firms in different stages of production and operation.
- Expands the espousing backward integration to assimilate sources of supply and forward integration towards market outlets.
- Vertical merger occurs when a firm acquires firms 'Upstream' from it or firms 'downstream' from it.
- In case of an 'Upstream' merger it extends to the firms supplying raw materials and to those firms that sell eventually to the consumer in the event of a 'down-stream' merger.
- When co combines with the supplier of materials it is called backward merger and when it combines with the customer it is known forward merger.
- EX: **Vertical Forward Integration** – Buying a customer
- Indian Rayon's acquisition of Madura Garments along with brand rights
- **Vertical Backward Integration** – Buying a supplier
- IBM's acquisition of Daksh
- Merits:
- Low buying cost of materials
- Lower distribution costs
- Assured supplies and market
- Increasing or creating barriers to entry for potential competitors
- Placing them at a cost disadvantage. Control over product specification
- Technological Economies

Carnegie Steel

- One of the earliest, largest and most famous examples of vertical integration was the Carnegie Steel company. The company controlled not only the mills where the steel was manufactured but also the mines where the iron ore was extracted, the coal mines that supplied the coal, the ships that transported the iron ore and the railroads that transported the coal to the factory, the coke ovens where the coal was coked, etc. The company also focused heavily on developing talent internally from the bottom up, rather than importing it from other companies.

American Apparel

- American Apparel is a fashion retailer and manufacturer that actually advertises itself as vertically integrated industrial company. The brand is based in downtown Los Angeles, where from a single building they control the dyeing, finishing, designing, sewing, cutting, marketing and distribution of the company's product. The company shoots and distributes its own advertisements, often using its own employees as subjects. It also owns and operates each of its retail locations as opposed to franchising. According to the

management, the vertically integrated model allows the company to design, cut, distribute and sell an item globally in the span of a week. [9] Since the company controls both the production and distribution of its product, it is an example of a **balanced vertically integrated** corporation.

Oil industry

- Oil companies, both multinational (such as ExxonMobil, Royal Dutch Shell, or BP) and national (e.g. Petronas) often adopt a vertically integrated structure. This means that they are active all the way along the supply chain from locating crude oil deposits, drilling and extracting crude, transporting it around the world, refining it into petroleum products such as petrol/gasoline, to distributing the fuel to company-owned retail stations, where it is sold to consumers.

3**. Conglomerate Merger**

- This occurs between companies engaged into two unrelated industries.
- Conglomerate merger represents a merger of firms engaged in unrelated lines of business.
- Rationale for such merger:Diversification of risk
- 3 types of Conglomerate merger:

  a) **Product-extension mergers** broaden the product lines of firms. These are mergers between firms in related business activities and may also be called **concentric mergers**. These mergers broden the product lines.
- **Product Extension**: New product in Present territory
- P&G acquires Gillette to expand its product offering in the household sector and smooth out fluctuations in earning.

  b)**geographic market-extension merger** involves two firms whose operations have been conducted in non overlapping geographic areas.
- Ex: Pizza Hut a fast food chain restaurant centered in USA, sought to wow Indian customers by opening their restaurant in all most all major urban centers of India.
- c) **Pure conglomerate mergers**involves unrelated business activities. These would not qualify as either product-extension or market extension.
- New product&New territories
- Indian Rayon's acquisition of PSI Data Systems.
- Mohta Steels with Vardhaman Spinning Mills Ltd.

4. **Concentric Mergers:**A merger in which there is carry –over in specific mgt functions (ex: mktg) or complementarily in relative strengths among specific mgt functions rather than carry-over/complementarities in only generic mgt functions (eg: planning).

Therefore, if the activities of the segments brought together are so related that there is carryover of specific mgt functions (mufg, finance, mktg, personnel, & so on) or

complementarily in relative strengths among these specific mgt functions, the merger should be termed concentric rather than conglomerate.

Ex: if one co., has competence in research, mufg., or mktg that can be applied to the pdt problems of another co., that lacks that particular competence, a merger will provide the opportunity to lower cost function.

Firms seeking to diversify from advanced technology industries my be strong on research but weaker on pdtn., and mktg., capabilities firms in industries with less advanced technology.

5.**Circular Combination/circular merger**

- This happens among companies producing distinct products to share common research and distribution facilities to obtain economies by elimination of cost on duplication and promoting market enlargement.
- Acquiring company has the benefit in form of economies of resource sharing and diversification
- When the firms belonging to the different industries and producing altogether different products combine together under the banner of central agency, it is referred as mixed or circular mergers.
- Ex: Merger of Sony (camera provider for mobiles)Erricson(cell phone producer)
- **Circular Merger** involves bringing together of products or services that are unrelated but marketed through the same channels, allowing shared dealerships. Ex: McLeod Russell (a tea company) with Eveready Industries (batteries).

Motives of Mergers

- Procurement of Supplies
- Market Expansion
- Financial Strength
- Diversification
- Taxation Benefits
- Managerial Motives
- Acquisitions of specific Assets
- Growth Advantage

- Revamping Production Facilities

1. **Procurement of Supplies**

- To safeguard the source of supplies of raw materials or intermediary products.
- To obtain economies of scale of purchase in the form of discount, saving in transportation costs, overhead cost in buying department, etc.
- To share the benefits of supplies economies by standardizing the material.

2. Market expansion & strategy

- To eliminate competition & protect existing market.
- To obtain new market outlets in possession of the offeree.
- To obtain new product for diversification or substitution of existing products & to enhance the product range.
- Strengthening retail outlets & sales depots to rationalize distribution.
- To reduce advertising cost & improve public image of the offeree company.

3. Financial Strength

- To improve liquidity & have direct access to cash resource
- To dispose of surplus & outdated assets for cash out of combined enterprise.
- To avail tax benefits.
- To improve EPS

4. Diversification

Mergers and acquisitions are motivated with objective to diversify the activities so as to avoid putting all the eggs in one basket & obtain advantage of joining the resource for enhanced debt financing & better serviceability to shareholders. Such amalgamations result in creating conglomerate undertakings.

5. Taxation benefits

Mergers take place to have benefits of tax laws &company having accumulated losses merge with profit earning company that will shield the income from taxation. Section 72 A of I.T act 1961 provides this incentive from reverse mergers for the survival of sick units.

6. Managerial motives

Managers benefit in rank, status and perquisites as the enterprise grows and expands because their salaries, perquisites & status often increase with the size of the enterprise. The acquirer may motivate managerial support by assuring benefits of larger size of the company to the managerial staff.

7. Acquisition of specific assets

Surviving company may purchase only the assets of the other company in merger. Sometimes vertical mergers are done with the motive to secure source of raw material but acquiree rather than acquiring the whole undertaking with assets and liabilities.

8. Growth Advantage

Mergers & Acquisitions are motivated with a view to sustain growth or to acquire growth. To develop new areas becomes costly, risky & difficult than to acquire a company in a growth sector even though the acquisition is on premium rather than investing in new assets or new establishments.

9. Revamping production facilities

- To achieve economies of scale by amalgamating production facilities through more intensive utilization of plant & resources.
- To standardize product specifications, improvement of quality of product, expanding market & aiming at customer satisfaction.
- To obtain improved production technology & know how from the offeree company to reduce cost, improve quality & produce competitive products to retain & improve market share.

OR

<u>Motives of M and A:</u>

a)Strategic Motives

- Expansion and growth
- Dealing with entry of MNC’s
- Economies of scale
- Synergy
- Market penetration
- Market leadership
- Backward/ Forward Integration
- New product entry
- New market entry
- Surplus resources
- Minimize size
- Risk reduction

- Balancing product cycle
- Growth and diversification strategy
- Re-fashioning

b) Financial Motives
  - Deployment of surplus funds
  - Fund raising capacity
  - Market capitalization
  - Tax planning
  - Creation of shareholders value
  - Tax benefits
  - Revival of sick units
  - Asset stripping(Selling assets for profit as it is not productive for the company)
  - Undervaluation of target company
  - Increasing EPS

c) Organizational Motives
  - Superior management
  - Ego satisfaction
  - Retention of managerial talent
  - Removal of inefficient management

Acquisition:

An **acquisition**, also known as a **takeover** or a **buyout**, is the buying of one company (the 'target') by another.

- Consolidation is when two companies combine together to form a new company altogether.
- An acquisition may be **private or public**, depending on whether the acquiree or merging company is or isn't listed in public markets.
- An acquisition may be friendly **or** hostile**.** Whether a purchase is perceived as a friendly or hostile depends on how it is communicated to and received by the target company's board of directors, employees and shareholders.
- It is quite normal though for M&A deal communications to take place in a so called **'confidentiality bubble'** whereby information flows are restricted due to confidentiality agreements.
- In the case of a **friendly transaction**, the companies cooperate in **negotiations**; in the case of a **hostile deal**, the **takeover target is unwilling** to be bought or the target's board has no prior knowledge of the offer.

- Hostile acquisitions can, and often do, turn friendly at the end, as the acquirer secures the endorsement of the transaction from the board of the acquiree company. This usually requires an improvement in the terms of the offer.
- Acquisition usually refers to a **purchase of a smaller firm by a larger one**. Sometimes, however, a smaller firm will acquire management control of a larger or longer established company and keep its name for the combined entity. This is known as a reverse takeover.
- Another type of acquisition is reverse merger, a deal which enables a private company to get publicly listed in a short time period. A **reverse merger** occurs when a private company that has strong prospects and is eager to **raise financing** buys a publicly listed shell company, usually one with no business and limited assets.
- Achieving acquisition success has proven to be very difficult, while various studies have shown that 50% of acquisitions were **unsuccessful**. The acquisition process is very **complex,** with many dimensions influencing its outcome. **There is also a variety of structures used in securing control over the assets of a company, which have different tax and regulatory implications**
- The buyer buys the **shares**, and therefore control, of the target company being purchased.
- The buyer buys the **assets** of the target company. The cash the target receives from the sell-off is paid back to its shareholders by dividend or through liquidation. This type of transaction leaves the target company as an empty shell, if the buyer buys out the entire assets.

Distinction between mergers and acquisitions

*Although often used synonymously, the terms **merger** and **acquisition** mean slightly different things.*

When one company takes over another and clearly establishes itself as the new owner, the purchase is called an a**cquisition**. From a legal point of view, the target company ceases to exist, the buyer "swallows" the business and the buyer's stock continues to be traded.

In the pure sense of the term, a **merger** happens when two firms agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals". The firms are often of about the same size. Both companies' stocks are surrendered and new company stock is issued in its place. For example, in the 1999 merger of Glaxo Wellcome and SmithKline Beecham, both firms ceased to exist when they merged, and a new company, GlaxoSmithKline, was created.

In practice, however, actual mergers of equals don't happen very often. Usually, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that

the action is a merger of equals, even if it is technically an acquisition. Being bought out often carries negative connotations, therefore, by describing the deal euphemistically as a merger, deal makers and top managers try to make the takeover more palatable. An example of this would be the takeover of Chrysler by Daimler-Benz in 1999 which was widely referred to in the time.

A purchase deal will also be called a **merger** when both CEOs agree that joining together is in the best interest of both of their companies. But when the deal is unfriendly - that is, when the target company does not want to be purchased - it is always regarded as an acquisition.

Theories of mergers

I. Efficiency theories

A. Differential managerial efficiency

B. Inefficient management

C. Operating synergy

D. Pure diversification

E. Strategic realignment to changing environments

F. Undervaluation

II. Information and signaling

III. Agency problems and managerialism

IV. Free cash flow hypothesis

v. Market power

VI. Taxes

VII. Redistribution.

1. Differential Efficiency

The differential efficiency explanation can be formulated more vigorously and may be called a managerial synergy hypothesis. If a firm has an efficient management team whose capacity is in excess of its current managerial input demand, the firm may be able to utilize the extra managerial resources by acquiring a firm that is inefficiently managed due to shortage of such resources.

For example, if the management of firm A is more efficient than the management of firm B and if after firm A acquires firm B, the efficiency of firm B is brought up to the level of efficiency of

firm A, efficiency is increased by merger. The level of efficiency in the economy would be raised by such mergers.

2. Inefficient Management

- Inefficient management is simply not performing up to its potential. Another control group might be able to manage the assets of this area of activity more effectively.
- Inefficient management theory could be a basis even for mergers between firms with unrelated businesses.
- Several observations can be made on the theory. First, the theory assumes that owners of acquired firms are unable to replace their own managers, and thus it is necessary to invoke costly mergers to replace inefficient managers.
- Second, if the replacement of incompetent managers were the sole motive for mergers, it should be sufficient to operate the acquired firm as a subsidiary rather than to merge it into the acquirer.
- Third, one clear prediction made by the theory is that the managers of the acquiring firm will be replaced after the merger. Empirical evidence suggests that this is not the case at least in conglomerate mergers. Based on his dissertation study of 28 conglomerate firms, Lynch (1971, USA) concludes that these firms tried to acquire companies with capable managements that could be retained.

3. Synergy

Synergy refers to the type of reaction that occur when two substances or factors combine to produce a greater effect together than that with the sum of the two operating independently could account for. It refers to the phenomenon 2+2=5.

❖ **FINANCIAL SYNERGY**

The impact of a corporate merger or acquisition on the costs of capital to the acquiring or the combined firm refers to financial synergy. Financial synergy occurs as a result of the lower costs of internal financing versus external financing. A combination of firms with different cash flow positions and investment opportunities may produce a financial synergy and achieve lower cost of capital.A firm in a declining industry will provide large cash flows since there are few attractive investment opportunities. A growth industry has more investment opportunities than cash with which to finance them

❖ **Operating Synergy**

- This theory assumes that economies of scale do exist in the industry and that prior to the merger; the firms are operating at levels of activity that fall short of achieving the potentials for economies of scale.
- Ex: one firm might be strong in cash but weak in marketing while another has strong marketing department without the R&D capability. Merging the two firms would result in operating synergy.
- One problem in merging is- how to combine and coordinate the good parts of the organization and eliminate what is not required?
- Vertical integration is one area in which operating economies may be achieved.
- Combining firms at difft stages of an industry may achieve more efficient coordination of the difft levels.

4. Pure Diversification

- First, in contrast to the position of shareholders who can diversify across firms in the capital market, employees of the firm have only a limited opportunity to diversify their labor sources. Diversification of the firm can provide managers and other employees with job security and opportunities for promotion and, other things being equal, results in lower labor costs.

- Second, in the modern theory of the firm, information on employees is accumulated within the firm over time. If the firm is diversified, teams can be transferred from unprofitable business activities to growing and profitable activities. Diversification may ensure smooth and efficient transition of the firm’s activities and the continuity of the teams and the organization.

- Third, firms have reputational capital which customers, suppliers and employees utilize in establishing their relationships with the firm. Diversification can help preserve the firm’s reputational capital which will cease to exist if the firm is liquidated.

- Fourth, diversification can increase corporate debt capacity and decrease the present value of future tax liability. These effects are a result of the decrease in cash flow variability due to the merger.

5. Strategic Realignment to Changing Environments

- Strategic planning is concerned with the firm’s environments and constituencies, not just operating decisions. The strategic planning approach to mergers implies either the possibilities of economies of scale or tapping an underused capacity in the firm's present managerial capabilities.

- The speed of adjustment through merger would be quicker than internal development. There may be opportunities to realize synergies in managerial capabilities. On the other hand, a competitive market for acquisitions implies that the net present value from merger and acquisition investments is likely to be small.

However, if these investments exploit synergy opportunities and can be used as a base for still additional investments with positive net present values, the strategy may succeed.

6. Undervaluation

- Some studies attribute merger motives to the undervaluation of target companies. One cause of undervaluation may be that management is not operating the company up to its potential.

- Second possibility is that the acquirers have inside information. How they acquired this special information may vary with circumstances, but if the bidders possess information which the general market does not have, they may place a higher value on the shares than currently prevails in the market.

- Another aspect of the under valuation theory is the difference between the market value of assets and their replacement costs.

II**. INFORMATION & SIGNALING**

- It attempts to explain why target shares seem to be permanently revalued ---- in a tender offer whether or not it is successful. The information hypothesis says that the tender offer sends a signal to the market that the target shares are undervalued or alternatively the offer signals information to target mgt., which inspires them to implement a more efficient strategy on their own.

III **AGENCY PROBLEMS AND MANAGERIALISM**

- It may result from a conflict of the interest b/w managers & shareholders or b/w shareholders & debt holders. A number of organization& market mechanisms serve to discipline self-serving managers & takeovers are viewed as the discipline of last resort.
- **Managerialism**: Managers want to increase the size of the company through mergers so as to increase their power and pay packages.

IV FREE CASH FLOW HYPOTHESIS

- It says that takeover take place because of the conflicts b/w managers & shareholders over the pay out of free cash flows. Hypothesis assumes that free cash flow should be paid out to shareholders reducing the power of mgmt.& subjecting managers to the security of the public capital markets more frequently.

V. **MARKET POWER**

- It claims that merger gains are the result of increased concentration leading to collusion & monopoly effects.

VI**. TAX EFFECTS**

- Carryover of net operating losses & tax credits, stepped-up asset basis & the substitution of capital gains for ordinary income are among the tax motivations.

VI. HUBRIS HYPOTHESIS

- It is an explanation of why mergers may happen even if the current market value of the target firm reflects its true economic value. It implies that managers look for acquisition of firms for their own potential motives & that the economic gains are not the only motivation for the acquisition.

VII. REDISTRIBUTION

- A final theory of the value increases to shareholders in takeovers is that the gains come at the expense of other stakeholders in the firm. Expropriated stakeholders under the redistribution hypothesis may include bondholders, the government (in the case of tax savings), and organized labor.

VII. **Q-ratio** : Q-ratio indicates the market value of shares to replacement cost of assets which may change due to inflation and depreciation. In order to have a satisfactory ratio, managers may want to buy undervalued assets and acquire assets more cheaply when the stock of the existing companies is less than the cost of purchase of such assets. The ideal q-ratio has to be between 0.5--0.6.

Operating, financial and managerial synergy of mergers

SYNERGY

- Synergy represents the two plus two equals to five effect(2+2=5) phenomenon. What is critical is how the extra gains are to be achieved. Synergy refers to the type of reactions that occur when two substances or factors combine to produce a greater effect together than that which the sum of the two operating independently could account for.
- One example of synergy is found in the history of pharmaceutical industry when after World War II the major firms shifted from producing bulk chemicals for others. To process to an emphasis on basic research and packaging products that were ready for final sale. A sales organization also was required. After a no. of years, synergistic mergers took place involving companies strong in research or marketing with companies that had complementary strengths and weaknesses.
- **TYPES OF SYNERGY**

1. Operating synergy
2. Financial synergy
3. Managerial synergy

- 1**. Operating synergy**
- Operating synergy or operating economies may be involved in horizontal and vertical mergers. For horizontal mergers the source of operating economies must represent a form of economies of scale. The economies, in turn, may reflect indivisibilities and better utilization of capacity after the merger.
- Another area in which operating economies may be achieved is vertical integration. Combining firms at different stages of an industry may achieve more efficient coordination of the different

levels. Costs of communication, and various forms of bargaining and opportunistic behaviour can be avoided by vertical integration.

- 2**. Financial synergy**
- The motive of the merger is to capture investment opportunities available in the acquired firm's industry by lowering the costs of capital of the combined firm through the merger and also utilizing lower-cost internal funds of the acquiring firm. The opportunity for utilizing the cash flows of the acquiring firm will be enhanced if the cash flow of the acquired firm is low.
- The decrease in bankruptcy probability may decrease the expected value of bankruptcy costs and increase the expected value of tax savings from interest payments for premerger debts, and thus increase the value of the combined firm by lowering its cost of capital.
- Internal funds do not involve transaction costs of the flotation process and may have differential tax advantages over external funds.
- The acquiring firms may supply lower-cost internal funds to the combined firm. Further, the acquired firms will typically have low free cash flows because high expected demand growth in their industries requires greater investments. The low free cash flows of the acquired firms provide synergistic opportunities in financing.
- Economies of scale in floatation and transaction costs of securities are another potential source of financial synergy.
- 3. **Managerial synergy**
- Now imagine a production process employing four factor inputs ---- generic managerial capabilities, industry-specific managerial capabilities, firm-specific nonmanagerial human capital and capital investment.
- The firm-specific non-managerial human capital can only be supplied by a long-term learning effort or by merging with existing firms in the same industry. The industry-specific managerial resources can be obtained by internal learning or by merging with a firm in the same or related industries.
- Suppose that a firm, call It B has 'excess capacity' in industry specific resources and that another firm in a related industry, call it T experiences 'shortages' in these resources.
- The acquisition of T by B will make the firms realize more balanced factor proportions between industry-specific and firm-specific resources by transferring the excess capacity of B in the industry-specific capabilities to T's operation.
- An example of the T-type firm will be an R&D oriented firm lacking marketing organizations and being acquired by a B-type firm with strong marketing capabilities in related fields of business.

Value creation in Horizontal, Vertical and Conglomerate mergers

a) **Horizontal merger**

- A horizontal merger is one that takes place between two companies that are essentially operating in the same market. Their products may or may not be identical. The horizontal merger takes place between business competition who are manufacturing, selling and distributing the similar type of service for profit.
- Horizontal merger results in reduction of competitors in the same industry. This, type of merger enables to derive the benefit of economies of scale & elimination of competition. But it leads to increase in monopolistic tendency in the market.
- For example, merger of Tata Oil Mills Company Ltd. with Hindustan Lever Ltd. is a horizontal merger. Both the companies have similar products.

b)Vertical Merger

- A vertical merger is one in which the company expands backwards by merging with a company supplying raw material or expands forward in the direction of the ultimate consumer. Thus in a vertical merger, there is a merging of companies engaged at different stages of the production cycle within the same industry.
- The vertical merger will bring the firms together who are involved in different stages of production, process or operation. A vertical merger allows for smooth flow of production, reduced inventory, and reduction in operating cost, increase in economies of scale, elimination of bottlenecks etc.

For example, the merger of Reliance Petrochemicals Limited with reliance industry limited is an example of vertical merger with backward linkage as far as RIL is concerned.

c) Conglomerate Merger

- In a conglomerate merger, the concerned companies are in totally unrelated lines of business. This type of merger involves the integration of companies entirely involve in a different set of activities, products or services. The merging companies are neither competitors nor complementary to each other.
- This form of merger is resorted to increase economic power, profitability , diversification of activities.
- For example, Mohta Steel Industries Limited merged with Vardhaman spinning mills Ltd.
- Conglomerate mergers are expected to bring about stability of income & profits, since the two units belong to different industries.

Internal and external change forces contributing to M & A activities

Or

Changing Factors contributing to Mergers & Acquisitions

1. Technological changes (technological requirements of firm has increased)
2. Economies of scale and complimentary benefits (growth opportunities among product areas are unequal)
3. Opening up of economy or liberalization of economy
4. Global economy (increase in competition)
5. Deregulation
6. New industries were created.
7. Negative trends in some economies.
8. Favorable economic & financial conditions (real time financial planning and control information requirements have increases).
9. Widening inequalities in income & wealth
10. High valuation on equities.
11. Requirement of human capital has grown relative to physical assets.
12. Increase in new product line.
13. Distribution and marketing methods have changed.

Internal Factors

- High Cost
- Less Profit
- Shortage of Inputs
- Excess Resources
- Low Growth
- Low Price
- Changing Factors contributing to Mergers & Acquisitions

External Factors

- Globalization- widened challenges and opportunities

- Technology- complexity and criticality of processes and methods
- Awakened customer- customer rules the business
- Stringent government norms- environment, labour, taxation, quality etc.
- Innovation-creative destruction- reduced product life cycle.
- More Competition

Pitfalls of Mergers and Acquisitions

- Combining operations may result in
  - Resistance from rank-and-file employees
  - Hard-to-resolve conflicts in management styles and corporate cultures
  - Tough problems of integration
  - Greater-than-anticipated difficulties in
    - Achieving expected cost-savings
    - Sharing of expertise
    - Achieving enhanced competitive capabilities

Financing M&A

Mergers are generally differentiated from acquisitions partly by the way in which they are financed and partly by the relative size of the companies. Various methods of financing an M&A deal exist:

- **Cash**

Payment by cash. Such transactions are usually termed acquisitions rather than mergers because the shareholders of the target company are removed from the picture and the target comes under the (indirect) control of the bidder's shareholders.

- **Stock**

Payment in the acquiring company's stock, issued to the shareholders of the acquired company at a given ratio proportional to the valuation of the latter.

Impact of M & A on stakeholders.

Acquisitions are generally assumed to be objective, or focused on the numbers. Consistent with this perspective, synergy is the most common justification for acquisition activity. Achieving synergy involves integrating firms to produce a combined performance greater than what they achieved independently. An implicit challenge then is to coordinate the efforts of groups with different interests to realize expected gains. This means that acquisitions quickly go from numbers to considering the impacts on people, as achieving synergy requires clear communication of the implications of an acquisition to impacted groups. As a result, considering and enlisting stakeholders becomes important to achieve success for any acquisition. Accomplishing a stakeholder analysis during acquisition planning can identify and address issues by helping to communicate information to influential groups. Still, gaps between different stakeholder groups are often not addressed in acquisitions, or they are considered too late. The starting point for any stakeholder analysis is identifying different groups and their interests. The perspective of seven stakeholder groups is briefly reviewed as a guide to improving acquisition outcomes.

1. **Employees**. The first group to consider relates to the impacted employees, as even the best strategy will fail if it does not consider the people needed to execute it. When employees learn of a merger, they expect and are prepared for dramatic changes. Employees will be hungry for information to cope with the uncertainty created by an acquisition. Employees will look to see that a plan for creating a better organization exists and for signals that people matter, as well as answers to what the acquisition means for them. This means employees will have little tolerance for delays that fail to set a clear direction that communicates their place in a merged firm. An example of something that can help reduce employee anxiety in large companies is an e-mail from the CEO to employees about a merger, so they learn about it from work and not the press. In smaller firms, a face to face meeting would be a better option to share news and implications of an acquisition. Without these steps, a lack of information to employees will only lead to speculation and resulting anxiety that will complicate integration efforts. Employee commitment to a merged firm is lowest following an acquisition announcement and increased employee turnover is a primary suspect in poor acquisition performance. An obvious reason for this is that the first employees to leave are generally the best and brightest. In other words, if an acquirer does not take steps to address the concerns of their employees they will likely find what they bought walked out the door when they were not looking. For example, many employees will get job offers from competitors within five days of an acquisition announcement. Successful acquirers focus on retaining employees, if for no other reason than to avoid the need to recruit old employees back at a higher salary. However, if the employees are not “on board” with the business and communication plan, competitors have a greater ability to frame the discussion with the market.

2. Competitors. While obvious in hindsight, it is easy to overlook this group. Failing to consider the actions of groups that want to see you fail can hurt your success, and competitive pressures driving the use of an acquisition to meet firm goals do not end once an acquisition is announced. Acquisition announcements are public and clarify what competitors can expect. Often competitors treat the inevitable distraction of combining firms as an opportunity. Not bound by restrictions of regulatory review competitors can immediately plant doubts with customers and

employees. For example, quality disruptions frequently occur during acquisitions from downsizing manufacturing capacity and transferring work to facilities with people unfamiliar with the products and processes used to produce them. Meanwhile, employees will also have lower commitment to a new organization. As a result, competitors also actively recruit from the employees and customers of firms involved in a merger when those firms are most vulnerable.

3**. Customers**. Merging firms often focus on internal issues during integration at the expense of external market issues, and customers of both acquirer and target firms are sometimes overlooked. For example, service disruptions during an acquisition results in two-thirds of merged businesses losing market share. Again, failing to address customer impacts in a communication plan will provide competitors an opportunity to frame customer perceptions on the impact of a merger. A strong emphasis on communicating with customers can reduce uncertainty and lower customer defection, as retaining customers may be more important to acquisition performance than reducing costs. In one example, while a combination of two hightechnology companies was meant to better serve IBM, uncertainty about implications of the merger led IBM to cut its orders for the firms in half because no one communicated what the acquisition meant to this important customer. Firms that communicate a continued commitment to their customers by considering their perspective during a merger can expect improved success.

4. Advisors. Completing an acquisition depends on advisors and incorporating an external perspective can enable better acquisition decisions. Additionally, more prestigious advisors can provide important reputation advantages. However, increasing the number of advisors increases the amount of time and money to complete a deal. This becomes an important consideration as the primary advantage of acquisitions involves speed or faster access to needed resources than internal development. Another consideration for public firms and sellers is that advisors may be required to help ensure managers fulfill their fiduciary obligations to shareholders. For example, as part of due diligence following an announcement to purchase Titan Corp for $2.4 billion, Lockheed Martin uncovered improper overseas payments that led to a Justice Department investigation and cancellation of the deal. It is unlikely irregularities, such as this one, could be found without the help of external auditors. Having a team of seasoned advisors can help find and account for negative information that can effect a deal’s value.

5. Lenders. Most acquirers include debt as part of their payment for a target, making lenders an important advisor. While lenders are interested in available collateral and the use of provided funds, they will also be interested in the projections of the merged firm and its ability to pay off the increased debt load. Selection of lenders is an important consideration, as more prestigious underwriters are associated with positive outcomes, such as completing deals faster. Banks may also be interested in marketing other services—a circumstance that can complicate their interests. For example, Barclays Capital recently agreed to pay Del Monte shareholders almost $90 million following conflict of interest surrounding allegations it steered the sale of Del Monte to bidders using it for financing. The desire for advisory fees may bias bank lending decisions, so prudence may drive keeping deal advisors and lenders separate.

6. Vendors. Acquisitions can also be disruptive to businesses a merged firm depends on. Suppliers of goods and services of merging companies will have a vested interest in their ability

to continue to supply a business and in being paid on a timely basis. It is not uncommon for vendors to require updated credit data for merging firms. Still, an acquisition offers the opportunity to consolidate vendors and increase bargaining power. As a result, vendors will want information about continued business. Communication with vendors, especially the key ones, is another critical piece of the overall acquisition communication plan. The last thing an acquiring company wants to learn is that a key vendor is skittish about the transaction and that they may not deliver scheduled product or service! In other words, without vendor support a merged firm can find it difficult to maintain normal operations.

7. Government Regulators. Firms planning an acquisition generally make filings with government agencies for regulatory approval that is followed by a waiting period that allows regulators to review information to consider labor or anticompetitive implications, and any conditions for completing a deal. For example, plant closings often require advance notice under state and federal law before it can be accomplished. Requirements for regulatory review go beyond the state and nation where firms are headquartered. For example, the European Union required concessions from Intel prior to providing regulatory approval of its McAfee acquisition. Only focusing on U.S. requirements likely hurt approval of the NYSE Euronext and Deutsche Borse merger, as Duncan Niederauer (CEO of NYSE Euronext) commented that he “misjudged the process” and that it was unlikely the merger would happen. While the focus for regulators is satisfying requirements, a more proactive approach goes from anticipating regulatory review to influencing it. However, going beyond providing information to regulators is a higher risk strategy. For example, AT&T employed a team of 93 lobbyists in Washington D.C. and spent $46 million in campaign contributions to both parties in a failed effort to get its bid for T-Mobile approved. This suggests that an obvious way to strengthen regulatory resistance is to announce a deal as a fait accompli before or during regulatory review. The risk of a deal failing regulatory approval has to be considered and dealt with along with at the start of in the negotiation process.

Employees:
Impact Of Mergers And Acquisitions on workers or employees:

Aftermath of mergers and acquisitions impact the employees or the workers the most. It is a well known fact that whenever there is a merger or an acquisition, there are bound to be lay offs.In the event when a new resulting company is efficient business wise, it would require less number of people to perform the same task. Under such circumstances, the company would attempt to downsize the labor force. If the employees who have been laid off possess sufficient skills, they may in fact benefit from the lay off and move on for greener pastures. But it is usually seen that the employees those who are laid off would not have played a significant role under the new organizational set up. This accounts for their removal from the new organization set up. These workers in turn would look for re employment and may have to be satisfied with a much lesser pay package than the previous one. Even though this may not lead to drastic unemployment levels, nevertheless, the workers will have to compromise for the same. If not drastically, the mild undulations created in the local economy cannot be ignored fully.

Management at the top:

Impact of mergers and acquisitions on top level management:

Impact of mergers and acquisitions on top level management may actually involve a "clash of the egos". There might be variations in the cultures of the two organizations. Under the new set up the manager may be asked to implement such policies or strategies, which may not be quite approved by him. When such a situation arises, the main focus of the organization gets diverted and executives become busy either settling matters among themselves or moving on. If however, the manager is well equipped with a degree or has sufficient qualification, the migration to another company may not be troublesome at all.

Shareholders:
Impact of mergers and acquisitions on shareholders:

We can further categorize the shareholders into two parts:

- The Shareholders of the acquiring firm
- The shareholders of the target firm.

Shareholders of the acquired firm:

The shareholders of the acquired company benefit the most. The reason being, it is seen in majority of the cases that the acquiring company usually pays a little excess than it what should. Unless a man lives in a house he has recently bought, he will not be able to know its drawbacks. So that the shareholders forgo their shares, the company has to offer an amount more than the actual price, which is prevailing in the market. Buying a company at a higher price can actually prove to be beneficial for the local economy.

Shareholders of the acquiring firm:

They are most affected. If we measure the benefits enjoyed by the shareholders of the acquired company in degrees, the degree to which they were benefited, by the same degree, these shareholders are harmed. This can be attributed to debt load, which accompanies an acquisition.

Strategic decisions need to go beyond the numbers to consider the stakeholders, or any group that is affected by a firm's initiatives. Once identified, planning to balance the interests of different groups can begin. Going "beyond the numbers" to consider the perspectives of different groups can provide a better appreciation of acquisition challenges and enable improved outcomes. The groups outlined here represent important groups, or a place to start, for any firm considering an acquisition.

Module 2: (5 Hours)

M & A – A strategic perspective- industry life cycle and product life cycle analysis in M&A decision, strategic approaches to M&A- SWOT analysis, BCG matrix, Porter's five forces model

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M & A – A strategic perspective

Mergers and Acquisition activities should take place within the framework of long range planning by business firms. M&A are the most popular means of corporate restructuring or business combinations. It is believed that mergers and acquisitions are strategic decisions leading to the maximization of the company's growth by enhancing its production and marketing operations. The reasons why M&A activities are considered to strategic in decision are:

- It includes huge amount of investment and the benefits are long term in nature.
- Maintaining or accelerating a company's growth, particularly when the internal growth is considered due to scarcity of resources.
- Enhancing profitability, through cost reduction resulting from economies of scale, operating efficiency and synergy.
- Diversifying the risk of the company, particularly when it acquires those businesses whose income streams are not correlated.
- Limiting the severity of competition by increasing the company's market power.
- Reducing tax liability because of the provision of setting off accumulated losses and unabsorbed depreciation of one company against the profits of another.

Strategy formulation is a sequential process which consists of strategic situation analysis by which is meant a company's analysis of the present scenario, its strengths and weaknesses and how they match with the opportunities and threats that the market analysis throws up. Strategic choice analysis involves a forward looking scenario building analysis by the company as to where does it see itself in the future, what kind of capability it must build to reach that position it sees for itself and most importantly how should it go about building these capabilities.

After the company has identified segments of the market to invest in, the next part of the strategy is market entry. The different entry level strategies available are:

- Organic growth
- Acquisitions or strategic alliances

The choice of entry strategy depends upon the market scenario and the industry life cycle which are governed by:

- Level of competition and growth
- Start-up and maturity risks
- Availability of organizational resource for organic growth and
- Advantage of speed of entry and exit

Industry life cycle and product life cycle analysis in M&A decision

- **INDUSTRY LIFE CYCLE**

FOUR DISTINCT STAGES

- INTRODUCTION OR PIONEERING STAGE
- GROWTH STAGE
- MATURITY STAGE
- DECLINE STAGE

1. PIONEERING STAGE

CHARACTERISTICS

1) No Ready Market

2) Sales Are Low

3) Important Pricing Strategy

2. GROWTH STAGE

CHARACTERISTICS

1) Increased Demand for Product

2) Increased Sales of Products

3) Entry of Competitors

4) Competition Oriented Pricing

3. MATURITY STAGE

CHARACTERISTICS

1) Demand Reaches Saturation Point

2) Tough Competition

3) Product Differentiation

4. DECLINE STAGE

CHARACTERISTICS

1) Sales begin to fall

2) Availability of new advanced products

3) Price margin get depressed

Role of Industry Life Cycle

Various Stages of Industry Life Cycle are –

- Fragmentation Stage
- Shake Out Stage
- Maturity Stage &
- Decline Stage

1.Fragmentation Stage:

- At this stage, the new industry normally arises when an entrepreneur overcomes the twin Problems of innovation and invention, and works out how to being the new product and services into the market.
- Example: Air travel services of major airlines in Europe were sold to a target market at a high price, concentrating on people with high income group. Ryan air was the first airline to engage low cost airlines in Europe. Its services were perceived as the innovation of the European Airline industry.

  Eliminated unnecessary services offered by traditional airlines. No free meals, uses paper-free air tickets, using secondary airports and offers frequent flights

2. Shake out Stage:

- During this stage, competitors start to realize business opportunities in the emerging industry. The value of the industry also rises.
- Example: UK govt. decided to launch a campaign to encourage people to quit smoking. Nicorette, a manufacturer of various nicotine products encouraged people quit smoking by giving them Nicolette patches and Nicorette gums. Nic Lite realized the opportunity and entered this industry and extended beyond UK border when the govt introduced non-smoking policy in public places. This business threat created a new business opportunity to launch Nic Time (an eight ounce bottle containing a lemon-flavored drink laced with nicotine, the same amount of nicotine as two cigarettes.

3. Maturity:

- A stage at which the efficiencies of the dominant business model give these organizations Competitive advantage over competition. Some companies may shift some of the production to overseas for gaining competitive advantage.
- Example – Toyota – export and import taxes mean that its cars lose competitiveness to the local competitors (in European market). Thus Toyota decided to open a factory at UK. Nike has factories in China and Thailand as both countries have cheap labor and materials. However, their overseas partners are not allowed to sell shoes produced. These have to be shipped back to US, and then will be exported to other countries.

4.Decline:

- A stage during which a war of slow destruction between businesses may develop and those with heavy bureaucracies may fail. In this stage, many companies may leave the industry or they may develop new products / services. This will create a new industry.
- Example : communication industry - the communication process of pagers couldn't be accomplished without telephones. To send messages to another pager, the user had to phone the call-center staff that would type and send message to another pager. On the other hand, people who use mobile phones can make a phone-call and send messages to other mobiles without going thru call-center staff.

Role of Industry & Product Life Cycle

The role of Industry Life Cycle is in much dispute, as this has never been supported by empirical evidence. But it represents a useful concept for organizing ideas on business activity. This concept is used as a framework for indicating, when different types of mergers may have an economic basis at different stages of an industry's development.

Stage of Industry Life Cycle	Types of Mergers
Introduction Stage	Newly created firms may sell to outside larger firms in a mature or declining industry, thereby enabling larger firms to enter into new growth industry. These results n related or conglomerate mergers. The smaller firms may wish to sell because they want to convert personal income to capital gain and because they do not want to place large investment in the hands of managers, who do not have long record of success. Horizontal mergers may take place between smaller firms in order to pool management & capital resources.
Growth & Exploitation Stage	Mergers during the exploitation stage are similar to mergers during Introductory stage. The major reasons for such mergers are reinforced by the more visible indications of prospective growth and profit and by the larger capital requirements of a higher growth rate.

Maturity Stage	To achieve Economies of scale in research, production and marketing in order to match low cost & price performance of other firms Domestic .Foreign). Some acquisitions of smaller firms by larger takes place for the purpose of rounding out the management skills of the smaller firms and providing them with broader financial base.
Decline Stage	Horizontal mergers are undertaken to ensure survival, Vertical mergers for increasing efficiency and profit margins. Concentric mergers involving firms in related industries provide opportunities for synergy and carry over. Conglomerate mergers with growth industries to utilize the accumulating cash position of mature firms in declining industries whose internal flow of funds exceeds the investment requirements of their traditional lines of businesses.

PRODUCT LIFE CYCLE AND MERGERS

- INTRODUCTION STAGE
  - NEWLY CREATED FIRMS SELL TO OUTSIDE LARGER FIRMS IN MATURE OR DECLINING INDUSTRY
  - HORIZONTAL MERGERS TAKES PLACE TO HAVE BETTER MANAGEMENT AND UTILISATION OF RESOURCES

- GROWTH STAGE

MERGERS TAKES PLACE BECAUSE OF

- Prospective Growth
- Profit And Larger Capital Requirement

- MATURITY STAGE

MERGERS TAKES PLACE TO

- Achieve Economies Of Scale
- Rounding Out Management Skills
- Broader Financial Base

- DECLINE STAGE

MERGERS TAKE PLACE FOR

- The Survival Of The Firms
- Increase Efficiency And Profit Margin

Strategic approaches to M&A

Mergers and acquisitions specialists assist businesses which are considering making changes to their corporate structure by joining forces with another company in some way. By combining expertise in corporate finance, corporate strategy and business management, M&A experts provide companies with expert advice regarding company restructure and the potential impact of a merger or acquisition.

Although the terms ‘merger’ and ‘acquisition’ are often used synonymously, they are in fact very different. A merger involves two companies joining together to become one company, whilst an acquisition generally involves one company buying out or taking over another company. The company which has been taken over or ‘acquired’ then ceases to exist. There are various strategic reasons for companies to consider making an acquisition and a successful takeover can help companies achieve their strategic objectives as well as increase cost effectiveness within the business.

However, the process of merging with another company or acquiring a company is extremely complex. In addition to the legal ramifications, companies must be aware of the potential tax implications as well as ensuring the terms of the deal benefit both parties. Often companies rely on lawyers and M&A specialists to negotiate on their behalf in order to obtain the best possible deal. By seeking the advice of mergers and acquisitions experts, businesses can obtain specialist advice and ensure they are aware of all the options available to them. In addition to providing information regarding the possible options available, merger and acquisition specialists can provide forecasts highlighting the potential effects of changes to the company structure. This can assist company management teams in deciding which option is most suitable and whether to go ahead with any proposed changes the company structure.

Although many companies consider mergers and acquisitions as opportunities for growth, they can provide a viable business solution for companies attempting to downsize or companies which are looking for an effective exit strategy. By divesting company assets, the company can reduce costs and streamline its operation leading to an increase in profitability. If companies have an underperforming department or subdivision, they can rely on mergers and acquisitions experts to help them dispose of the asset effectively and in accordance with their overall business strategy.

By helping companies prepare for potential mergers and acquisitions, corporate finance specialists can help maximize the sale value of a firm or asset and obtain the best terms of sale for their client. Negotiating terms for a merger or acquisition can be a long and laborious process so companies often rely on M&A specialists to guide them through the process and ensure they meet compliance requirements as well as ensuring they achieve the best possible terms. Although

complex, a merger or acquisition can be a rapid way for companies to achieve their objectives and increase company growth. The complexity of a merger or acquisition, in addition to the impact on the business if the deal goes ahead, means that companies should obtain specialist advice from M&A experts prior to closing a deal. By engaging with merger and acquisition specialists, companies can ensure they are acting in according with their business strategy, complying with the relevant regulations and acting in the best interest of the company, its shareholders, investors and staff.

SWOT ANALYSIS

• Identifying Strengths, Weaknesses, Opportunities and Threats would appear to be easily accomplished. However much subjectivity is involved. While opportunities may exist, the difference in cost may require careful balancing of consideration. On balance, this approach may provide a useful starting point developing a strategic planning process and to stimulate strategic thinking in an organization.

The Key Distinction - Internal and External Issues

Strengths and weaknesses are internal factors. For example, strength could be your specialist marketing expertise. A weakness could be the lack of a new product.

Opportunities and threats are external factors. For example, an opportunity could be a developing distribution channel such as the Internet, or changing consumer lifestyles that potentially increase demand for a company's products. A threat could be a new competitor in an important existing market or a technological change that makes existing products potentially obsolete.

it is worth pointing out that SWOT analysis can be very subjective - two people rarely come-up with the same version of a SWOT analysis even when given the same information about the same business and its environment. Accordingly, SWOT analysis is best used as a guide and not a prescription. Adding and weighting criteria to each factor increases the validity of the analysis.

Areas to Consider

Some of the key areas to consider when identifying and evaluating Strengths, Weaknesses, Opportunities and Threats are listed in the example SWOT analysis below:

	Positive	Negative
Internal factors	**Strengths** ➢Technological skills ➢Leading Brands ➢Distribution channels ➢Customer Loyalty / Relationship ➢Production quality ➢Scale ➢Management	**Weaknesses** ➢Absence of important skills ➢Weak brands ➢Poor access to distribution ➢Low customer retention ➢Unreliable product / service ➢Sub-scale ➢Management
External factors	**Opportunities** ➢Changing customer tastes ➢Liberalisation of geographic markets ➢Technological advances ➢Changes in government politics ➢Lower personal taxes ➢Change in population age-structure ➢New distribution channels	**Threats** ➢Changing customer tastes ➢Closing of geographic markets ➢Technological advances ➢Changes in government politics ➢ Tax increases ➢Change in population age-structure ➢New distribution channels

BCG matrix

Introduction

The **business portfolio** is the collection of businesses and products that make up the company. The best business portfolio is one that fits the company's strengths and helps exploit the most attractive opportunities.

The company must:

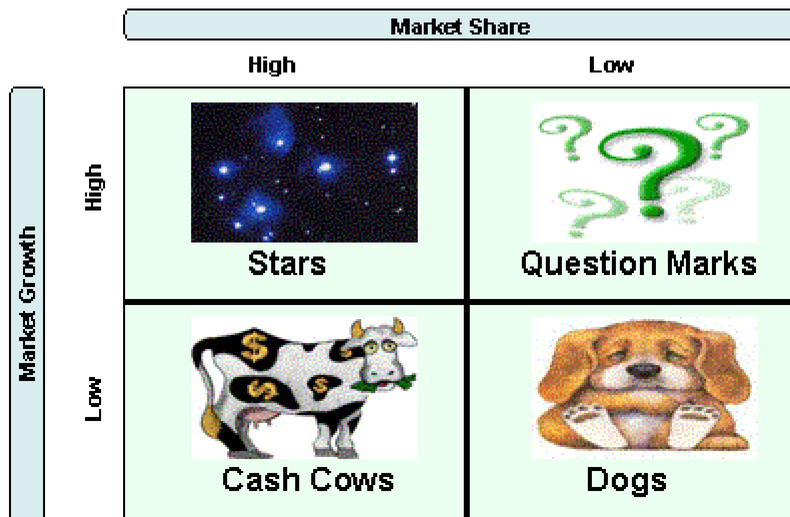
(1) Analyse its current business portfolio and decide which businesses should receive more or less investment, and

(2) Develop growth strategies for adding new products and businesses to the portfolio, whilst at the same time deciding when products and businesses should no longer be retained.

Methods of Portfolio Planning

The two best-known portfolio planning methods are from the Boston Consulting Group (the subject of this revision note) and by General Electric/Shell. In each method, the first step is to identify the various Strategic Business Units ("SBU's") in a company portfolio. An SBU is a unit of the company that has a separate mission and objectives and that can be planned independently from the other businesses. An SBU can be a company division, a product line or even individual brands - it all depends on how the company is organised.

The Boston Consulting Group Box ("BCG Box")



Using the BCG Box (an example is illustrated above) a company classifies all its SBU's according to two dimensions:

On the horizontal axis: relative market share - this serves as a measure of SBU strength in the market

On the vertical axis: market growth rate - this provides a measure of market attractiveness

By dividing the matrix into four areas, four types of SBU can be distinguished:

Stars - Stars are high growth businesses or products competing in markets where they are relatively strong compared with the competition. Often they need heavy investment to sustain

their growth. Eventually their growth will slow and, assuming they maintain their relative market share, will become cash cows.

Cash Cows - Cash cows are low-growth businesses or products with a relatively high market share. These are mature, successful businesses with relatively little need for investment. They need to be managed for continued profit - so that they continue to generate the strong cash flows that the company needs for its Stars.

Question marks - Question marks are businesses or products with low market share but which operate in higher growth markets. This suggests that they have potential, but may require substantial investment in order to grow market share at the expense of more powerful competitors. Management have to think hard about "question marks" - which ones should they invest in? Which ones should they allow to fail or shrink?

Dogs - Unsurprisingly, the term "dogs" refers to businesses or products that have low relative share in unattractive, low-growth markets. Dogs may generate enough cash to break-even, but they are rarely, if ever, worth investing in.

Using the BCG Box to determine strategy

Once a company has classified its SBU's, it must decide what to do with them. In the diagram above, the company has one large cash cow (the size of the circle is proportional to the SBU's sales), a large dog and two, smaller stars and question marks.

Conventional strategic thinking suggests there are four possible strategies for each SBU:

(1) Build Share: here the company can invest to increase market share (for example turning a "question mark" into a star)

(2) Hold: here the company invests just enough to keep the SBU in its present position

(3) Harvest: here the company reduces the amount of investment in order to maximise the short-term cash flows and profits from the SBU. This may have the effect of turning Stars into Cash Cows.

(4) Divest: the company can divest the SBU by phasing it out or selling it - in order to use the resources elsewhere (e.g. investing in the more promising "question marks").

MARKET GROWTH	HIGH	STARS (Invest)	QUESTION MARK (Divested)
	LOW	COWS	DOGS (Liquidate)
		HIGH	LOW
		MARKET SHARE	

- This is associated with the Boston Consulting Group. Products for which the firm has high market share in an industry with favorable growth rates are potential STARS" with high profitability. As an industry matures, its growth slows, so that a firm continues to have high market share. The attractive profits are available for investments in market, so that the product becomes "CASH COW".

- Products and market with low growth where the firm has a small market share are "DOGS" & "Question Marks", and the firm should discontinue such products according to single product portfolio method.

3 CONCEPTS - BCG MATRIX

1. **The Experience Curve**: represents Cost-Volume relationship. It is argued that as the volume increases, unit costs will fall. This is said to result from specialization, standardization, learning and scale effect. Thus the firm with largest cumulative output will have lower cost, suggesting a strategy for early entry and price policies to develop volume.

2. **Product Life Cycle**: Every product proceeds through development, growth, maturity and decline. During first 2 stages sales growth is rapid and entry is easy. As in individual firm gain experiences and as growth slows in the last 2 stages, entry becomes difficult because of cost advantages. In decline phase, sales and price decline, no favorable position and unprofitable, hence they should either merge or exit from industry.

3. **Portfolio Balance**: This is related to PLC, rapid growth may require substantial investments. Such business segments are likely to require more investment funds that are generated by current profitable levels. As the requirements for growth diminish, profits

may generate more funds than required for current investment portfolio balance seeks to combine attractive investment segments (stars) with cash cows. Elimination segments with unattractive prospects (Dogs & Question marks). Overall, total corporate cash inflows will roughly balance total corporate investments.

Porter's five forces model

Introduction

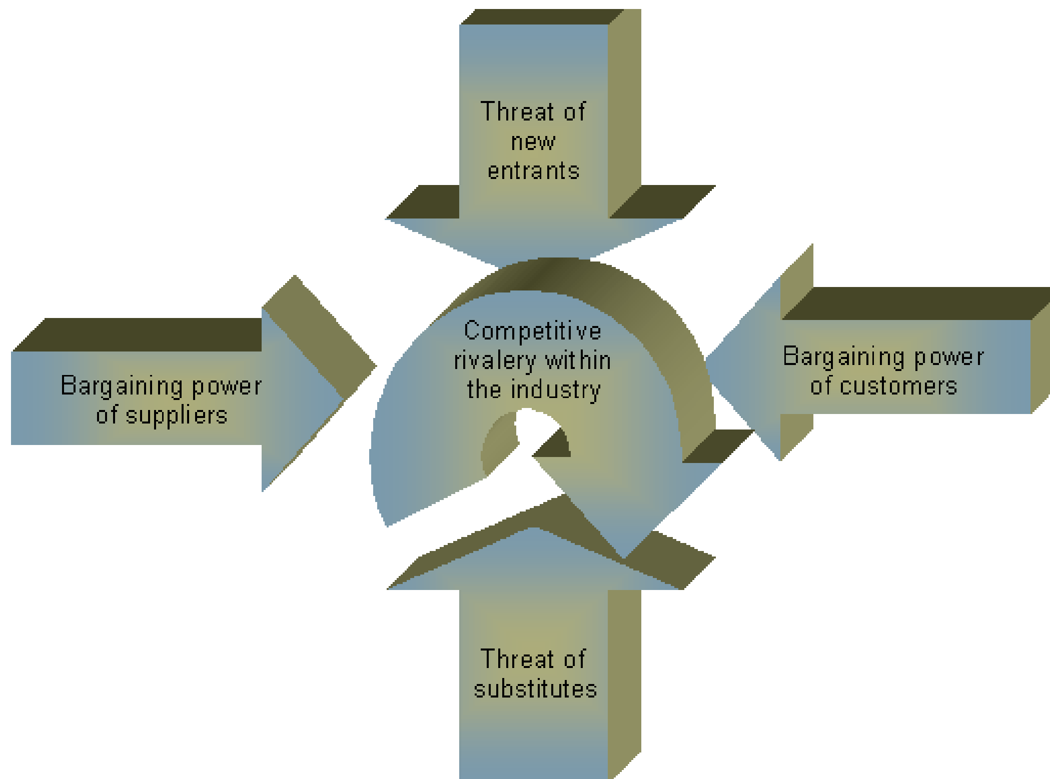
The model of the Five Competitive Forces was developed by Michael E. Porter in his book „Competitive Strategy: Techniques for Analyzing Industries and Competitors"in 1980. Since that time it has become an important tool for analyzing an organizations industry structure in strategic processes.

Porter's model is based on the insight that a corporate strategy should meet the opportunities and threats in the organizations external environment. Especially, competitive strategy should base on and understanding of industry structures and the way they change.

Porter has identified five competitive forces that shape every industry and every market. These forces determine the intensity of competition and hence the profitability and attractiveness of an industry. The objective of corporate strategy should be to modify these competitive forces in a way that improves the position of the organization. Porter's model supports analysis of the driving forces in an industry. Based on the information derived from the Five Forces Analysis, management can decide how to influence or to exploit particular characteristics of their industry.

The Porter's Five Competitive Forces

The Five Competitive Forces are typically described as follows:



- **Bargaining Power of Suppliers**

The term 'suppliers' comprises all sources for inputs that are needed in order to provide goods or services.

Supplier bargaining power is likely to be high when:

- The market is dominated by a few large suppliers rather than a fragmented source of supply,
- There are no substitutes for the particular input,
- The suppliers customers are fragmented, so their bargaining power is low,
- The switching costs from one supplier to another are high,
- There is the possibility of the supplier integrating forwards in order to obtain higher prices and margins. This threat is especially high when
- The buying industry has a higher profitability than the supplying industry,
- Forward integration provides economies of scale for the supplier,

- The buying industry hinders the supplying industry in their development (e.g. reluctance to accept new releases of products),

- The buying industry has low barriers to entry.

In such situations, the buying industry often faces a high pressure on margins from their suppliers. The relationship to powerful suppliers can potentially reduce strategic options for the organization.

- **Bargaining Power of Customers**

Similarly, the bargaining power of customers determines how much customers can impose pressure on margins and volumes.

Customers bargaining power is likely to be high when

- They buy large volumes, there is a concentration of buyers,

- The supplying industry comprises a large number of small operators

- The supplying industry operates with high fixed costs,

- The product is undifferentiated and can be replaces by substitutes,

- Switching to an alternative product is relatively simple and is not related to high costs,

- Customers have low margins and are price-sensitive,

- Customers could produce the product themselves,

- The product is not of strategical importance for the customer,

- The customer knows about the production costs of the product

- There is the possibility for the customer integrating backwards.

- **Threat of New Entrants**

The competition in an industry will be the higher; the easier it is for other companies to enter this industry. In such a situation, new entrants could change major determinants of the market environment (e.g. market shares, prices, customer loyalty) at any time. There is always a latent pressure for reaction and adjustment for existing players in this industry.

The threat of new entries will depend on the extent to which there are barriers to entry. These are typically

· Economies of scale (minimum size requirements for profitable operations),

· High initial investments and fixed costs,

· Cost advantages of existing players due to experience curve effects of operation with fully depreciated assets,

· Brand loyalty of customers

· Protected intellectual property like patents, licenses etc,

· Scarcity of important resources, e.g. qualified expert staff

· Access to raw materials is controlled by existing players,

· Distribution channels are controlled by existing players,

· Existing players have close customer relations, e.g. from long-term service contracts,

· High switching costs for customers

· Legislation and government action

- **Threat of Substitutes**

A threat from substitutes exists if there are alternative products with lower prices of better performance parameters for the same purpose. They could potentially attract a significant proportion of market volume and hence reduce the potential sales volume for existing players. This category also relates to complementary products.

Similarly to the threat of new entrants, the threat of substitutes is determined by factors like

· Brand loyalty of customers,

· Close customer relationships,

· Switching costs for customers,

· The relative price for performance of substitutes,

· Current trends.

Competitive Rivalry between Existing Players

This force describes the intensity of competition between existing players (companies) in an industry. High competitive pressure results in pressure on prices, margins, and hence, on profitability for every single company in the industry.

Competition between existing players is likely to be high when

- There are many players of about the same size,
- Players have similar strategies
- There is not much differentiation between players and their products, hence, there is much price competition
- Low market growth rates (growth of a particular company is possible only at the expense of a competitor),
- Barriers for exit are high (e.g. expensive and highly specialized equipment).

Michael Porter has elaborated his views in number of writings. His approach can be summarized as –

- **Select an attractive Industry**.

Porter defines an attractive industry or strategic group as *“one in which, entry barriers are high, suppliers & buyers have only modest bargaining power, substitute products or services are few & the rivalry among competitors is stable.”*

- **Develop Competitive advantage through Cost Leadership and Product Differentiation**.

Competitive advantage may be based on cost leadership or on product differentiation. Cost advantage is achieved by consideration of wide range of checklist factors including BCG’s learning curve theory. The focus of cost advantage or of product differentiation can be narrow market segments or niche (BMW, Mercedes) or broader market groups or across the board (GM)

- **Develop attractive value chains.**

A matrix that relates the support activities of infrastructure, HRM, Technological development and procurement to the primary activities of inbound logistics, marketing, sales and service. The aim is to minimize outlay in adding characteristics valued by customers.

Module 3: (9 Hours)

Corporate restructuring – significance - forms of restructuring – joint ventures – sell off and spin off – divestitures – equity carve out – leveraged buy outs (LBO) – management buy outs – master limited partnerships – Limited Liability Partnership (LLP) in India: Nature and incorporation of LLP-De merger- strategic alliance- buyback of shares-employee stock ownership plans (ESOP)

Corporate restructuring

•Corporate restructuring refers to the changes in ownership, business mix, asset mix & alliance with a view to enhance the shareholders value. Hence, corporate restructuring may involve ownership restructuring, business restructuring, asset restructuring for the purpose of making it more efficient and more profitable.
•A company can affect ownership restructuring through mergers & acquisitions, leveraged buy outs, buy back of shares, spin-offs, joint venture & strategic alliance.
•Business restructuring involves the reorganization of business units or divisions. It includes diversification into new businesses, out sourcing, divestment, brand acquisitions etc.
•Asset restructuring involves the acquisition or sale of asset & their ownership structure. E.g. Sale & lease back of assets, securitization of debts, receivable factoring, etc.

Purpose of Corporate Restructuring

❖ The basic purpose is to enhance the share holder value.
❖The company should continuously evaluate its portfolio of businesses, capital mix & ownership & assets arrangements to find opportunities to increase the share holders' value.
❖It should focus on asset utilization & profitable investment opportunities, & reorganize or divest less profitable or loss making businesses/products.
❖The company can also enhance value through capital restructuring; it can innovate securities that help to reduce cost of capital.

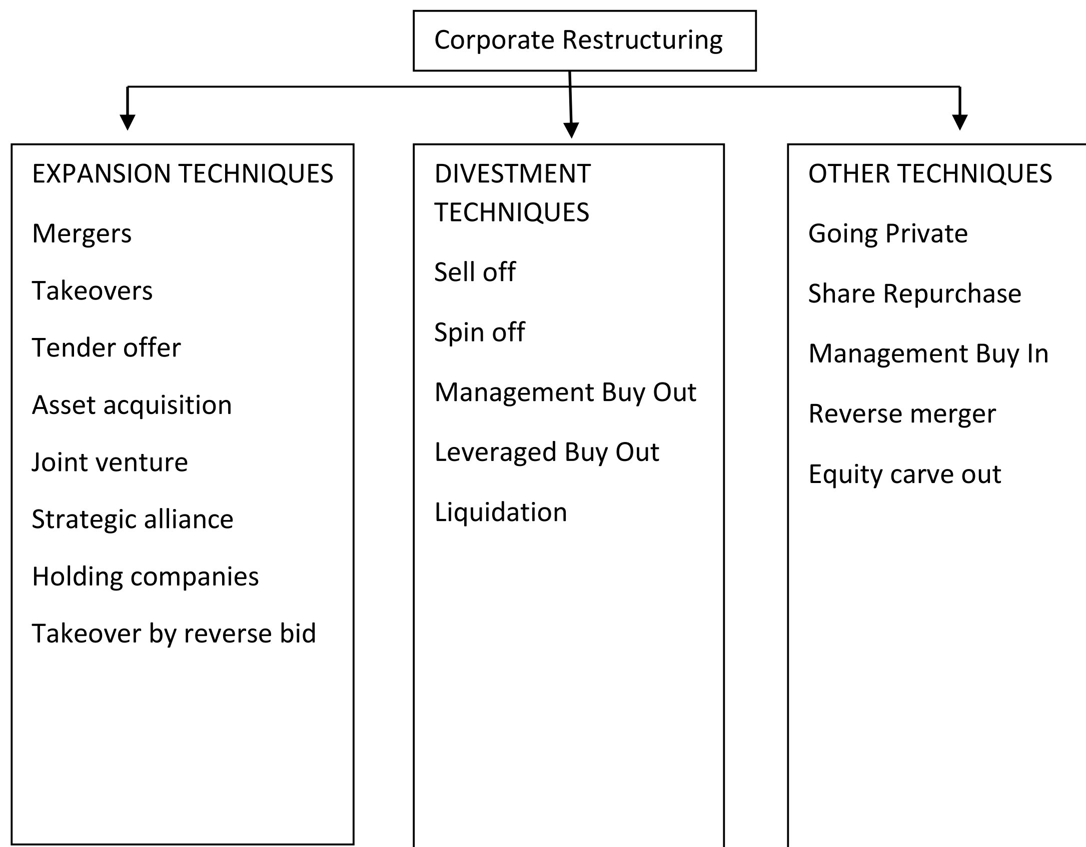
Significance

- Limit competition
- Utilize under-utilised market power
- Overcome the problem of slow growth and profitability in one's own industry
- Achieve diversification
- Gain economies of scale and increase income with proportionately less investment
- Establish a transnational bridgehead without excessive start-up costs to gain access to a foreign market
- Utilize under-utilised resources- human and physical and managerial skills
- Displace existing management
- Circumvent government regulations

- Reap speculative gains attendant upon new security issue or change in P/E ratio.
- Create an image of aggressiveness and strategic opportunism, empire building and to amass vast economic powers of the company.

Forms of restructuring

Forms of Corporate Restructuring



Different Methods of Corporate Restructuring

- Joint Venture
- Divestitures
- Corporate sell-off
- Corporate spin-off
- Equity Carve Out
- Leveraged Buyout
- Management buyouts
- Master Limited partnerships
- Employee Stock ownership plans

Merger And Takeover (refer 1st chapter)

Tender offer

Tender offer involves making a public offer for acquiring the shares of the target company with a view to acquire management control in that company.

Ex: Flextronics International gave an open market offer at Rs. 548 for 20% paid-up capital in Hughes Software systems.

Hostile Takeover and Tender Offer

Takeover refers to a change in the controlling interest of a company. Takeover can be friendly or unfriendly.

In a **friendly takeover** the target company's management is receptive to the idea and recommends approval by shareholders. The acquiring company has to offer a premium to the current market price of the share to gain control. If the shareholders approve, the transaction is finalized through purchase of the target company's shares for cash, exchange of shares, debt or some combination of all three.

In an **unfriendly or hostile takeover** the target company's management does not support the solicitation from a potential acquirer because of the inadequacy of purchase price.

A **Tender Offer** is a formal offer to purchase a given number of a company's shares at a specified price. The acquiring company asks the shareholders of the target company to 'tender' their shares in exchange for a specific price. The price is generally quoted at a premium in order to induce the shareholders to tender their shares. Tender offer can be used in 2 situations. First, the acquiring company may directly approach the target company for its takeover. If the target company does not agree, then the acquiring company may directly approach the shareholders by means of a tender offer. Second, the tender offer may be used without any negotiations, and it may be equivalent to a hostile takeover. The shareholders are generally approached through announcement in the financial press or through direct communication individually. They may or may not react to a tender offer. Their reaction exclusively depends upon their attitude and sentiment and the difference between the market price and offer price. The tender offer may or may not be acceptable to the management of the target company.

Asset acquisition

Asset acquisition involves buying the assets of another company. These assets may be tangible assets like a manufacturing unit or intangible assets like brands. The acquirer purchases only those parts which benefits or satisfies firm's needs.

- The acquisition of the cement division of TATA Steel by Laffarage of France. Laffarage acquired only the 1.7 million tons cement plant and its related assets from TATA Steel.
- Coca-Cola paid Rs.170 Crores to Parle to acquire its soft drinks like Thums-Up, Limca and Gold Spot.

Joint Venture

- A joint venture is a business enterprise under-taken by two or more persons or organizations to share the expense and profit of a particular business project.
  Eg. Maruthi Suzuki, ING Vishya, Bajaj Allianz, Standard & Charted Bank.
- A Joint venture is a legal entity formed between two or more parties to under-take economic activity together. The parties agree to create a new entity by both contributing equity, and they then share in the revenues, expenses, and control of the enterprise.
- The venture can be for one specific project only, or a continuing business relationship such as the **Sony Ericsson** joint venture. This is in contrast to a strategic alliance, which involves no equity stake by the participants, and is a much less rigid arrangement.

Rational behind JV:

- Pooling of complimentary resources
- Access to raw-materials
- Access to new markets
- Diversification of risks
- Economies of scale
- Tax shelter
- Cost reduction
- Purchaser- supplier relationships
- Joint manufacturing

Types of Joint Ventures

- **Equity based joint ventures** benefit foreign and/or local private interests, groups of interests, or members of the general public.
- Under **non-equity joint ventures** (also known as cooperative agreements), meanwhile, the parties seek technical service arrangements, franchise and brand use agreements, management contracts, rental agreements, or one-time contracts, e.g. for construction projects. Participants do not always furnish capital as part of their joint venture commitments. They want to modernize operations or start new production operations.

E.g. BIAL- Bangalore International Airport Ltd. is a joint venture between Central Govt., State Govt. & Switzerland Airport Authority.

Reasons for forming a Joint Venture

1. Internal Reasons

- Spreading costs and risks.
- Improving access to financial resources
- Economies of scale and advantages of size
- Access to new technologies and customers

- Access to innovative managerial practices.

2. Competitive Goals

- Influencing structural evolution of the industry
- Pre-empting competition
- Defensive response to blurring industry boundaries
- Creation of stronger competitive units
- Speed of market
- Improved agility.

What Stimulates Joint Venture?

- ❖ A bigger cash rich company tries to invest in small companies with inadequate surplus.
- ❖ Distribution of risk.
- ❖ Acquisition of technological or managerial resources at a comparatively lower cost.
- ❖ As a long-term strategy to establish controlling power in the market and keep the competitors at a distance.
- ❖ Tax consideration.
- ❖ To improve and establish efficient distribution channel or supply chain.

Benefits of Joint Ventures

- ❖ Among the most significant benefits derived from joint ventures is that partners save money and reduce their risks through capital and resource sharing.
- ❖ Joint ventures also give smaller companies the chance to work with larger ones to develop, manufacture and market new products.
- ❖ They also give companies of all sizes the opportunity to increase sales, gain access to wider markets, and enhance technological capabilities through research and development underwritten by more than one party.
- ❖ E.g. Xerox Corporation & Fuji Corporation in Japan engaged in a joint venture that allowed Xerox to penetrate Japanese market & Fuji can enter into photo-copy business.
- ❖ Govt.'s increased involvement in the private business environment has created more opportunities for companies to engage in domestic and international joint ventures.

Reasons for Failure of JV

- Lower than expected turnover.
- Expiry of Technical tie up.
- Economic Recession.
- Reluctance of Management to accept additional responsibility.
- Distance and language barrier.
- Unfavorable profitability ratio – Post JV arrangement.
- Lack of openers between JV constituents.

Strategic Alliance:

- Is a flexible arrangement between firms whereby they agree to work together to achieve a specific goal. Such arrangements are looser in nature than the JV and can be disbanded easily.
- A partnership with another business in which you combine efforts in a business effort involving anything from getting a better price for goods by buying in bulk together, to seeking business together, with each of you providing part of the product. The basic idea behind alliances is to minimize risk while maximizing the leverage.
- Normally, a strategic alliance does not result in the creation of new entity unlike a JV. The major advantage of a strategic alliance is that it can be created easily as and when there is a need.

Types of Strategic Alliances:

- Franchising: An agreement whereby someone with a good idea for business (the franchiser) sells the rights to use the business's name and sell a product/service to someone else (the franchisee).
- Licensing: A form of strategic alliance which involves the sale of a right to use certain proprietary knowledge, i.e., intellectual property.
- Management Contracts
- Turnkey Projects
- Partnering with suppliers
- Pooled purchasing
- Partnering with distributors

JV Vs Strategic Alliance:

JV	Strategic Alliance
Formed to capitalize on knowledge in parent firms and to generate knowledge	Formed in order to learn from the partners knowledge
Two or more organizations set up a separate, independent organization for a specific purpose	B2B collaboration where two or more corporate shares resources and capabilities to achieve some business purpose.
A formal contract is written	Less formal than JV's. A new entity need not be created.
It has clear and legal boundaries	Boundaries are defined by partnering firms

Holding companies

Holding company controls the subsidiary company by acquiring substantial voting powers by acquiring equity shares carrying voting rights. When it hold 100% shares of subsidiary company, then it is called as wholly owned subsidiary Holding company is also called as parent company. More than 50% of the shares of the subsidiary are held by parent company either directly or indirectly.

Takeover by Reverse Bid

Normally a large company takeover a small company. But when a small company acquires a big company in a takeover manner, such a situation is called as takeover by reverse bid. It happens when substantial shares of big company are in the hands of a small company. It is possible when small company is a cash rich company and big company is a sick company.

DIVESTITURE / DEMERGER

- Divestiture: Sale of segment of a company (assets, a product line, a subsidiary) to a third party for cash and/or securities.

- Although divestitures causes contraction from the perspective of selling firm, it doesn't however, entail decrease in its profits.
- It is believed that, the value will be enhanced by parting / divesting / demerging some of its assets as they are either causing losses or yielding very low returns.

Motives of Divestitures

- **Raising Capital**

It is a common motive. Cash strapped firms seem to resort to divestiture to shore up their liquidity.

E.g. CEAT sold its nylon tyre cord plant at Gwalior to SRF for Rs. 3250 million so that it could settle its out standings and raise funds to concentrate on tyre manufacturing.

- **Curtailment of losses**

Prominent reason is to cut losses. It may imply that the unit that is proposed to be divested is earning a sub normal rate of return.

- **Strategic Realignment**

The sellers may divest a unit which no longer fits with its strategic plan. Often such a unit tends to be in an unrelated line and may demand a lot of managerial time & attention.

- **Efficiency Gain**

A divestiture results in an efficiency gain when the unit divested is worth more as part of some other firm or as a standalone business.

- **Inability to adopt new technology.**
- **Underperformance of Labor including managers.**
- **Subsidiaries not able to exploit advantages of new policies.**

Financial Evaluation of Divestiture

Procedures:

Step 1: Estimate the divisional post tax cash flow

Step 2: Establish the discount rate for the division

Step 3: Calculate the division's present value

Step 4: ***Find the market value of the division-specific liabilities-*** The MV is the PV of the obligations arising from the liabilities of the division.

Step 5: A*ssume the value of the parent firm's ownership position in the division* – the value of the ownership position enjoyed by the parent firm is PV of the division's cash flow (Step 3)-MV of the division's specific liabilities. (Step 4)

Step 6: ***Compare the value of the ownership firm with the divestiture proceeds-***When a parent firm transfers the assets of a division along with its liabilities, it receives divestiture proceeds as compensation for giving up its ownership position in the division.

Forms of Corporate Divestitures

- Inter-corporate sell-off: that is sale to another company
- Spin-off or de-merger
- Equity Carve out, in which a subsidiary is floated on a stock exchange, but parent, retains a majority control.
- Issue of tracking stock
- Management buyout

1. **Corporate sell-offs**

- A sell-off is a transaction between two independent companies. The divestor may benefit from the cash proceeds, which could be put to more profitable use in the businesses within the group, or used to mitigate financial distress.
- Sell-off may also add to the divestor by eliminating negative synergy, or by realizing managerial resource preempted by the divested business.
  - It may also sharpen the strategic focus of the remaining businesses & enhance the divestor's competitive strength.
  - Selling a part or all of the firm by any one of means: sale, liquidation, spin-off & so on . Or
  - General term for divestiture of part/all of a firm by any one of a no. of means: sale, liquidation, spin-off and so on.

PARTIAL SELL-OFF/ SLUMP SALE

- A partial sell-off/slump sale, involves the sale of a business unit or plant of one firm to another.
- It is the mirror image of a purchase of a business unit or plant.
- From the seller's perspective, it is a form of contraction;
- From the buyer's point of view it is a form of expansion.
- For example:
- When Coromandal Fertilizers Limited sold its cement division to India Cement Limited, the size of Coromandal Fertilizers contracted whereas the size of India Cements Limited expanded.

2. Corporate spin-offs

- In a corporate spin-off, a company floats off a subsidiary which may be small part of the parent company. The newly floated company now has an independent existence and is separately valued at the stock market.
- Shares in the spin-off company are distributed to the shareholders of the parent company; they own shares in two companies rather than just one. The parent company does not receive any proceeds from the demerger, as the demerged company's shares are directly distributed to the parent company shareholders.
- A corporate spin-off divides a company into two or more independent firms, and offers a firm an opportunity to improve managerial incentives with fresh compensation packages.

- This is the reversal of mergers or acquisitions.
- Denotes a transaction in which a company distributes on a pro-rata basis, all the shares of its own in a subsidiary to its own shareholders.
- EX: United Breweries (Flagship CO.) UB Holdings Ltd. For every 600 Shares held 400 Shares are given.
- In the year 1997, PepsiCo spun-off KFC, Pizza Hut and Taco Bell into a separate corporation Tricon Global Restaurants Inc. The company spun-off 100% of its restaurant unit to stock holders who received shares in the new company. The spin-off was aimed at better focus on its Pepsi beverage operations and Frito Lay snack business.

Benefits for a spin-off

- A spin off like other form of divestitures, lead to enhanced focus, reduced organizational complexity & control loss, & avoid of negative synergy.
- Eliminate the conglomerate discount the parent may have suffered as a diversified company.
- Increase the transparency of both the parent & the spin-off business to the stock market through separate financial reports of the two firms to current share holders.

- Increase analyst & institutional investor following, create new shareholders & allow to access to new capital.
- Allow shareholders increased flexibility in their portfolio decisions, since they now have the freedom to alter the proportion of their portfolios invested in each company.

Split off

A transaction in which some, but not all, parent company shareholders receive shares in a subsidiary in return for relinquishing(surrendering) their parent company shares. A split-off is a type of corporate reorganization whereby the stock of a subsidiary is exchanged for shares in the parent company. Split-off is basically of two types. In the first type, a corporation transfers part of its assets to a new corporation in exchange for stock of the new corporation. The original corporation then distributes the same stock to its shareholders, who, in turn, surrender part of their stock in the original corporation. In the second type, a parent company transfers stock of a controlled corporation to its stock holders in redemption of a similar portion of their stock. “Control” refers to the ownership of 80% or more of the corporation whose shares are being distributed.

Difference between Spin-off and Split-off

A split-off differs from spin-off in that the shareholders in a split-off must relinquish (surrender) their shares of stock in the parent corporation in order to receive shares of the subsidiary corporation, whereas the shareholders in a spin-off need not do so.

Split up

A transaction under which a company spins off all of its subsidiaries to its shareholders and ceases to exist. In a split-up, the existing corporation transfers all its assets to two or more new controlled subsidiaries, in exchange for subsidiary stock. The parent distributes all stock of each subsidiary to existing shareholders in exchange for all outstanding parent stock, and liquidates. In other words, a single company splits into 2 or more separately run companies.

One of the classical examples for split-up is the split-up of AT & T into four separate units- AT & T Wireless, AT&T Broadband, AT & T Consumer, AT & T Business. It could be termed as one of the biggest shake-ups in the US Telecommunication industry since 1984.

3. Equity Carve Out

- An equity carve out is the initial public offering (IPO) of the some portion of the common stock of a wholly owned subsidiary. These are also referred to as “split off IPO”.
- An IPO of the equity of a subsidiary resembles a seasoned equity offering of the parent in that cash is received from a public sale of equity securities.
- An equity carve out is the sale of a minority or a majority voting control in a subsidiary by its parent to outside investors.
- Equity carve out is similar to a spin-off in many ways.

They are often motivated by the need to:

- Increases the focus of the firm
- Improves the autonomy of the component businesses
- Improve the managerial incentive structure by relating management performance directly to the share holder value.
- Enhance the visibility of the component businesses being divested.
- Minimize the conglomerate discount through this enhanced visibility & increased information.

Leveraged Buyout

- Acquisition of one company by another, typically with borrowed funds. Usually, the acquired company's assets are used as collateral for the loans of the acquiring company.
- The loans are paid back from the acquired company's cash flow. Another possible form of leveraged buyout occurs when investors borrow from banks, using their own assets as collateral to acquire the other company. Typically, public stockholders receive an amount in excess of the current market value for their shares.

Types of LBO

- Investment buyouts (IBO)
- Management buyouts (MBO)
- Management buy-in (MBI)
- Going private buyouts

1. **Management Buyout**

A management buyout (MBO) is a form of acquisition where a company's existing managers buy or acquire a large part of the company.

- Purchase of all of a company's publicly held shares by the existing mgt., which takes the company private. Usually, mgt. Will have to pay a premium over the current market price to entire public shareholders to go along with the deal. If mgt. has to borrow heavily to finance the transaction, it is called a Leveraged Buyout (LBO)
- Managers may want to buy their company for several reasons: They want to avoid being taken over by a raider who would bring in new mgt., they no longer want the scrutiny that comes with running a public company; or they believe they can make more money for themselves in the long run by owning a larger share of the company, and eventually reap substantial profits by going public again with a Reverse Leveraged Buyout

2. **Management Buy-in**

- A management buy-in (MBI) occurs when a manager or a management team from outside the company raises the necessary finance, buys it and becomes the company's new management.
- A management buy-in team often competes with other purchasers in the search for a suitable business. Usually, the team will be led by a manager with significant experience at managing director level.

Difference between MBO and MBI

- The difference to a management buy-out is in the position of the purchaser: In the case of a buy-out, they are already working for the company. In the case of a buy-in, however, the manager or management team is from another source.

Going Private:

Converting a company whose stock is publicly held into a Private company. The transformation of a public company into a pvt. Company is called as "Going Private".

Master Limited Partnership

- Master limited partnership is a limited partnership that is publicly traded on securities exchange. It combines the tax benefits of a limited partnership with the liquidity of publicly traded securities.
- Master limited partnerships are limited by US Code to only apply to enterprises that engage in certain businesses, mostly pertaining to the use of natural resources, such as petroleum and natural gas extraction and transportation. Some real estate enterprises may also qualify as MLPs.
  - In practice, MLPs pay their investors through quarterly required distributions (QRD), the amount of which is stated in the contract between the limited partners (the investors) and the general public (the managers). Failure to pay the QRD may constitute an event of default.
  - A group led by an executive of the company or members of a units management, buy out the unit. They form a partnership but the shares of the partnership firm they form are traded. Since the shares are traded in the market, the liabilities of the shareholders are limited. This is called Master Limited Partnership (MLP).

Features of MLP:

► Limited Liability.
► Centralized Management.
► Longer Life (Partnership forever)
► Transferability of Stock.

Types of MLP's

- **Roll up MLP**: Combination of two or more partnerships forming one publicly traded partnership.

- **Liquidation MLP**: Formed by complete liquidation of a corporation and converting it into a MLP.
- **Acquisition MLP**: Formed by offering part of the MLP's interest (shares) to public and using the proceeds to purchase assets.
- **Roll out MLP**: Formed by a corporation's contribution of operating assets in exchange for general and limited partnership interests (shares) of the MLP followed by a public offering of limited partnership interest.

Advantages of MLPs

- Unlimited life
- Limited liability
- Centralized management
- Transferability
- Tax savings, avoids double taxation

Employee Stock Ownership Plan (ESOP)

- An ESOP is a type of stock bonus plan which invests primarily in the securities of the sponsoring employer firm.
- ESOPs are qualified, defined contribution, employee benefit (ERISA-employee retirement income security act of 1974) plan designed to invest primarily in the stock of the sponsoring employer.
- ESOPs are qualified in the sense that the ESOP's sponsoring company, the selling shareholder and participants receive various tax benefits.
- ESOPs are often used as a corporate finance strategy and are also used to align the interests of a company's employees with those of the company's shareholders.
  - A parent company sells a portion of its equity in wholly owned subsidiary.
  - Alternatively, an equity carve-out is the initial public offering (IPO) of some portion of the common stock of a wholly owned subsidiary. These are referred to as "SPLIT –OFF IPO's". When ECO take place, the management of the carved out entity is brought to sharp focus.
  - The real market value of the subsidiary gets established. There can be periodical reports about the functioning of the subsidiary for public information. A general growth performance can have a positive influence both on the performance as well as share value. Normally, the management also gets suitably rewarded. In such a situation, the parent company may decide to sell for considerable profit.

Arguments in favor of Sell-off, Spin- Off & Equity Carve Out

- Availability and utility of information.
- Due recognition of managerial efficiency.

- Dissimilar activities are segregated. Ex: Warner Lambed (Vicks Vaporub) sold its Bakery division – Entermann to General Food. This is called as "POOR-FIT THEORY".
- Managerial Incentives
- Tax and regulatory factors (In US ,trusts have lower tax rate). In India, slab rates can be taken advantage.
- Provides choice to bidders.

Types of ESOPs

- **Leveraged:** The plan borrows funds to purchase securities of the employer firm. The employer firm makes contribution to the ESOP trust in an amount to meet the annual interest payments on the loan as well as the repayment of the principal.
- **Leveragable:** The plan is authorized, but it is not required to borrow funds.
- **Non leveraged:** are essentially stock bonus plans which are required to invest primarily in the securities of the employer firm.
- **Tax credit:** (provided by tax reduction act of 1975) in addition to the regular credit in existence at that time, an additional investment credit of 1% of a qualified investment in plant & equipment could be earned by a contribution of that amount to an ESOPs.

Benefits

- Employee stock ownership plans (ESOPs) are set up by companies as a kind of employee benefit trust.
- An ESOP is a type of employee benefit plan designed to invest primarily in employer stock.
- To establish an ESOP, a firm sets up a trust and makes tax-deductible contributions to it. All full-time employees with a year or more of service are normally included.
- The ESOP can be funded through tax-deductible corporate contributions to the ESOP. Discretionary annual cash contributions are deductible for up to 25% of the pay of plan participants and are used to buy shares from selling owners.
- Alternatively, the ESOP can borrow money to buy shares, with the company making tax-deductible contributions to the plan to enable it to repay the loan.

- Contributions to repay principal are deductible for up to 25% of the payroll of plan participants; interest is always deductible.
- Dividends can be paid to the ESOP to increase this amount over 25%. Sellers to an ESOP in a closely held company can defer taxation on the proceeds by reinvesting in other securities.

- Stock acquired by the ESOP is allocated to accounts for individual employees based on relative pay or some equal formula. Accounts Employees also can acquire stock through grants of stock options, the right to buy shares at a price set today for a defined number of years into the future.

Disadvantages

- A common complaint lodged against employee-owned corporations is that, like unions, the employees elect the leaders, but the leaders are not necessarily responsible to the employees.
- Also, employee-owned corporations often have troubles with slow decision making.
- It can also make an unhealthy share of an employee's finances dependent on one source, if they have not spread their investing to other areas.
- The large majority of employee ownership companies do not provide for employee elections of the board. In those that do, the research shows, with few exceptions, that employees do not use that influence to make significant changes in corporate policy.
- It is much more common for employee ownership companies to provide for substantial employee involvement in work-level decisions, often through various kinds of teams.
- There is no data to show whether decision-making in these companies is slower or faster. But the data shows that companies that combine employee ownership with a high degree of employee involvement at the job level actually grow 6% to 11% faster per year than would have otherwise been expected.
- Diversification is a problem.

EQUITY CARVE OUT AS A CORPORATE RESTRUCTURING

- It is also known as partial spin off or Partial public offerings or split-off IPO.
- SPIN OFF: occurs when the entire ownership of a subsidiary is divested as dividend to shareholders
- Equity carve out; are an IPO of a stake in a subsidiary. The parent usually keeps majority ownership
- Usually occurs when a co. decides to IPO one of their subsidiaries The co. usually only offers a minority share to the equity market
- DEFINITION: Diluting the ownership right of original or existing share holders by issuing new common stock (ordinary shares) of a firm to new investors. Equity Carve out, in which a subsidiary is floated on a stock exchange, but parent retains a majority control.

Limited Liability Partnership (LLP) in India: Nature and incorporation of LLP

NATURE OF LIMITED LIABILITY PARTNERSHIP (LLP)

1. Concept of “limited liability partnership”

•LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership.

•The LLP can continue its existence irrespective of changes in partners. It is capable of entering into contracts and holding property in its own name.

•The LLP is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP.

•Further, no partner is liable on account of the independent or un-authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner’s wrongful business decisions or misconduct.

•Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners or between the partners and the LLP as the case may be. The LLP, however, is not relieved of the liability for its other obligations as a separate entity.

Since LLP contains elements of both ‘a corporate structure’ as well as ‘a partnership firm structure’ LLP is called a hybrid between a company and a partnership.

2. Structure of an LLP

LLP shall be a body corporate and a legal entity separate from its partners. It will have perpetual succession.

3. Advantages of LLP form

LLP form is a form of business model which:

(i) is organized and operates on the basis of an agreement.

(ii) provides flexibility without imposing detailed legal and procedural requirements

(iii) enables professional/technical expertise and initiative to combine with financial risk taking capacity in an innovative and efficient manner

4. Other countries where this form is available

The LLP structure is available in countries like United Kingdom, United States of America, various Gulf countries, Australia and Singapore. On the advice of experts who have studied LLP legislations in various countries, the LLP Act is broadly based on UK LLP Act 2000 and Singapore LLP Act 2005

. Both these Acts allow creation of LLPs in a body corporate form i.e. as a separate legal entity, separate from its partners/members.

5. Difference between LLP & "traditional partnership firm"

•Under "traditional partnership firm", every partner is liable, jointly with all the other partners and also severally for all acts of the firm done while he is a partner.

•Under LLP structure, liability of the partner is limited to his agreed contribution. Further, no partner is liable on account of the independent or un-authorized acts of other partners, thus allowing individual partners to be shielded from joint liability created by another partner's wrongful acts or misconduct.

6. Difference between LLP & a Company

•A basic difference between an LLP and a Company lies in that the internal governance structure. A company is regulated by statute (i.e. Companies Act, 1956) whereas for an LLP it would be by a contractual agreement between partners.

•The management-ownership divideinherent in a company is not there in a limited liability partnership.

•LLP will have more flexibility as compared to a company.

•LLP will have lesser compliance requirements as compared to a company.

APPLICABILITY OF THE LLP Act

7. Whether the LLP Act is applicable to any specific services like professional services regulated by Statutes?

No.

Any two or more persons associating for carrying on a lawful business with a view to profit may set up an LLP. In the light of various inputs received by this Ministry for applicability of the LLP form to small entities and venture capital funded enterprises, it is proposed that the framework should not be restricted to professional services alone as was earlier recommended by Naresh Chandra Committee. Accordingly, the LLP Act does not restrict the benefit of LLP structure to certain classes of professionals only.

8. Likely users/beneficiaries of the LLP Law?

India has witnessed considerable growth in services sector and the quality of our professionals is acknowledged internationally. It is necessary that entrepreneurship knowledge and risk capital combine to provide a further impetus to our impressive economic growth. Equally the services sector promises an economic opportunity similar to that provided by information technology over the past few years. It is likely that in the years to come Indian professionals would be providing accountancy, legal and various other professional/technical services to a large number

of entities across the globe. Such services would require multidisciplinary combinations that would offer a menu of solutions to international clients.

In view of all this, the LLP framework could be used for many enterprises, such as:-

•Persons providing services of any kind

•Enterprises in new knowledge and technology based fields where the corporate form is not suited.

•For professionals such as Chartered Accountants (CAs), Cost and Works Accountants (CWAs), Company Secretaries (CSs) and Advocates, etc.

•Venture capital funds where risk capital combines with knowledge and expertise

•Professionals and enterprises engaged in any scientific, technical or artistic discipline, for any activity relating to research production, design and provision of services.

•Small Sector Enterprises (including Micro, Small and Medium Enterprises)

•Producer Companies in Handloom, Handicrafts sector

De merger

A business strategy in which a single business is broken into components, either to operate on their own, to be sold or to be dissolved. A de-merger allows a large company, such as a conglomerate, to split off its various brands to invite or prevent an acquisition, to raise capital by selling off components that are no longer part of the business's core product line, or to create separate legal entities to handle different operations.

The act of splitting off a part of an existing company to become a new company, which operates completely separate from the original company. Shareholders of the original company are usually given an equivalent stake of ownership in the new company. A demerger is often done to help each of the segments operate more smoothly, as they can now focus on a more specific task. **opposite of** merger.

Buyback of shares

The repurchase of outstanding shares (repurchase) by a company in order to reduce the number of shares on the market. Companies will buy back shares either to increase the value of shares still available (reducing supply), or to eliminate any threats by shareholders who may be looking for a controlling stake.

Buy-back of shares is a method of financial engineering. It can be described as a procedure which enables a company to go back to the holders of its shares and offer to purchase the shares held by them.

Buy-back helps a company by giving a better use for its funds than reinvesting these funds in the same business at below average rates or going in for unnecessary diversification or buying growth through costly acquisitions.

When a company has substantial cash resources, it may like to buy its own shares from the market particularly when the prevailing rate of its shares in the market is much lower than the book value or what the company perceives to be its true value.

This mode of purchase is also called ‘Shares Repurchase’. A company can utilize its reserves to buy-back equity shares for the purpose of extinguishing these or treasure operations. The former option results in reduction of the paid up capital, and consequently higher earnings and book value per share. Naturally, the market price of equity goes up.

The reduction in share capital strengthens the promoter’s control and enhances the equity value for shareholders. In the latter option, companies buy their shares from open market and keep these as ‘treasury stock’.

This enables the promoters to strengthen their control over the shares bought back, without any investment of their own. In case of treasure operations, there is a diversion of company’s funds to buy shares and reduction in the value of equity for the shareholders.

The main aim of shares repurchase might be reduce the number of shares in circulation in order to improve the share price, or simply to return to the shareholders resources no longer needed by the company.

The shares repurchase may be by way of purchase from the open market or by general tender offer to all shareholders made by the company to repurchase a fixed amount of its securities at pre-stated price.

Objectives of Buy Back: Shares may be bought back by the company on account of one or more of the following reasons

i. To increase promoters holding

ii. Increase earnings per share

iii. Rationalise the capital structure by writing off capital not represented by available assets.

iv. Support share value

v. To thwart takeover bid

vi. To pay surplus cash not required by business

Infact the best strategy to maintain the share price in a bear run is to buy back the shares from the open market at a premium over the prevailing market price.

Module 4: (7 Hours)

Merger Process: Dynamics of M&A process - identification of targets – negotiation – closing the deal. Five-stage model – Due diligence – Types - due diligence strategy and process – due diligence challenges.

Process of merger integration – organizational and human aspects – managerial challenges of M & A

Merger Process:

Steps in Merger or Merger Process

1. Screening and investigation of merger proposal
2. Negotiation stage
3. Approval of proposal by Board of Directors
4. Approval of shareholders
5. Approval of creditors/financial institutions/banks
6. Tribunal's approval
7. Approval of central government
8. Integration stage

1. Screening and investigation of merger proposal

When there is an intention of acquisition or merger, the primary step is that of screening. The motives and the needs are to be adjudged against three strategic criteria i.e. business fit, management and financial strength. If the proposal is viable after thorough analysis from all angles, then the matter will be carried further.

2. Negotiation stage

In this stage the bargain is made in order to secure the highest price by the seller and the acquirer keen to limit the price of the bid. The seller needs to decide the minimum price acceptable and the buyer needs to decide the maximum he is prepared to pay. After the consideration is decided then the payment terms and exchange ratio of shares between the companies will be decided. The exchange ratio is an important factor in the process of amalgamation.

3. **Approval of proposal by Board of Directors**

Deciding upon the consideration of the deal and terms of payments, then the proposal will be put for the Board of Director's approval.

4. **Approval of shareholders**

As per the provisions of the Companies Act 1956, the shareholders of both seller and acquirer companies hold meeting under the directions of the National Company Law Tribunal and they consider the scheme of amalgamation. A separate meeting for both preference and equity shareholders is convened for this purpose.

5. **Approval of creditors/financial institutions/banks**

Approvals from the constituents for the scheme of merger and acquisition are required to be sought for as per the respective agreement with each of them and their interest is considered in drawing up the scheme of merger.

6. **Tribunal's approval**

The tribunal shall issue orders for winding up of the amalgamating company without dissolution on receipt of the reports from the Official Liquidator and the Regional Director that the affairs of the amalgamating company have not been conducted in a manner prejudicial to the interest of its members or to public interest.

7. **Approval of central government**

It is required to obtain declaration of the Central Government on the recommendation made by the Specified Authority under section 72 A of the Income Tax Act, if applicable.

8. **Integration stage**

The structural and cultural aspects of the two organization, will lead to successful merger and ensure that expected benefits of the merger are realized.

Dynamics of M&A process –

- identification of targets
- negotiation
- closing the deal.

The Five Stage (5-S) Model

The M&A process can be divided into five stages:

1. Corporate Strategy Development
2. Organizing for acquisitions
3. Deal structuring and negotiation
4. Post-acquisition integration and

5. Post-acquisition Audit and organizational learning.

Stage 1

Corporate Strategy Development

- Corporate strategy is concerned with ways of optimizing the portfolios of businesses that a firm currently owns and with how this portfolio can be changed to serve the interests of the corporation's stakeholders. M&A is one such activity which achieves the objectives of both corporate and business strategies.
- Corporate strategies are based on various models like industry structure driven, competition among strategic groups, competence or resource based competition, etc. firms make acquisitions to gain market power, gain economies of scale and scope or internalize vertically linked operations to save on cost of dealing with markets, this adding further cost savings.
- ;

Stage 2

Organizing for Acquisition

- A precondition for a successful acquisition is that the firm organizes itself for effective acquisition making. An understanding of the acquisition decision process is important, since it has a bearing on the quality of the acquisition decision and its value creation logic.
- A frame work is developed for effective organization of the M&A function. The aim of this framework is to develop the acquisition function as an important organizational capability and as a core competence of the firm.
- At this stage the firm lays down the criteria for potential targets of acquisitions consistent with the strategic objectives and value creation logic of the firm's corporate strategy and business model.

Stage 3

Deal Structuring and Negotiating

This stage consists of

- Valuing target companies, taking into account how the acquirer plans to leverage its own assets with those of the targets.
- Choice of advisors to the deal such as investment bankers, lawyers etc.
- Performing due diligence

- Determining the range of negotiation parameters
- Negotiating the positions of senior management of both the firms in the post merger firm
- Developing the appropriate bid and defense strategies and tactics within the parameters set by relevant regulatory regime, etc.

Stage 4

Post Acquisition Integration

This is a very important stage, the objectives of which is to put in place a merged organization that can deliver the strategic and value expectations that drove the merger in the first place. Integration has the characteristics of a change management programme but here three types of change may be involved:

- Change of the target firm
- Change of the acquiring firm
- Change in the attitude and behavior of both to accommodate co-existence or fusion of the two firms.

Stage 5

Post Acquisition Audit & Organization Learning

The importance of organizational learning to the success of future acquisitions needs much greater recognition, given the high failure rate of acquisitions.

Post merger audit by internal auditors can be acquisition specific as well as being part of an annual audit. Internal auditors have a significant role in ensuring organizational learning and its dissemination.

Due Diligence

Due diligence is nothing but a detailed evaluation. Once a proposal has passed through initial screening, it is subjected to a detailed evaluation or due diligence process.

Types

The are three components of Due Diligence:-

- Financial Due Diligence
- Legal Due Diligence
- Strategic Due Diligence

- **Financial Due Diligence**

Financial evaluation is the most important part of the due diligence. It is needed to determine the earnings and cash flows, areas of risk, the maximum price payable to the target company and the best way to finance the merger. A merger is said to be at a premium when the offer price is higher than the target firm's pre-merger market value. The acquiring firm may pay the premium if it thinks that it can increase the target firm's profits after merger by improving its operations and due to synergy.

- **Legal Due Diligence**

Any M&A activity needs a lot of structuring such that they are within the tax and legal frame work. Any merger to happen successfully, has to be structured in such a way that they are tax efficient, compliant with SEBI, FDI, Capital Market and Government rules and regulations.

- **Strategic Due Diligence**

It tests the strategic rationale behind a proposed transaction with two broad questions:

1. Is the deal commercially attractive?
2. Are we capable of realizing the targeted value?

The first question testing the commercial attractiveness of the deal involves validating both the target company's financial projections and identified synergies using an external lens.

Regarding the second question, a company must make a hard internal examination of whether the targeted value of the deal can be realized by the management team of the combined enterprise and, if so, whether the projected time frame is realistic.

Human Resource Management issues during Integration

1. Changing the Board of Directors

Board of Directors may have to be revamped to align directorial expertise with the emerging needs of the post merger business. The new board should be change leaders so that they can carry out the change process dictated by the merger. It could be inspirational for the rest of the organization. This is particularly so where the merging partners had experienced performance problems, which triggered the merger.

2. The senior job to be done

In all integration types, there will be rival claims for senior executive positions such as the chairman, CEO, heads of divisions, heads of functions such as R&D etc, if both merging firms had these positions prior to the merger. The choice of the right person for the right job is important because otherwise the success of the merger will be jeopardized.

3. Head count reduction

In absorption type integration with its emphasis on savings through consolidation of duplicate functions, head count reduction is perhaps inevitable. While legal regulations such as Transfer of Undertakings Protection of Employment Act (TUPE) in the UK, and protective legislation in other countries, employees have to be treated with some minimal decency. However managing head count reduction should be driven not by legal minimalism but by transparently genuine concern for the welfare of the people being made redundant. Companies often arrange for counseling, training and outplacement programmes to alleviate the distress to the employees.

4. Key people retention

A merger is also a time when firm's competitors attempt to capitalize of the uncertainty and lure away the "stars" as happened in many investment banks undergoing mergers.

E.g. scientist – left job during Glaxo and Smith Kline Beecham merger.

For retention of star employees special bonuses and stock options were given. All probably already wealthy, may be tempted to stay not with offers of more wealth but with positions of power and prestige that reflect their merit.

5. Aligning performance measurement and reward systems

Where the merger firms have different approaches to measuring and rewarding performance, attempts to align the evaluation and incentive systems may evoke hostile responses from the staff adversely affected by between two firms and altering the balance to introduce more pay-to-performance sensitivity may endanger resentment and resistance. However, changing the performance evaluation and reward systems may be a necessary element in evolving a new culture because of their power to motivate staff and influence their behavior.

6. Managing conflicting expectations

Mergers are characterized by exceptional ambiguity. The expectation of outside stakeholders and the stock market analyst may differ from those of internal stakeholders such as top management and employees. Expectations may also differ as to the time scale for delivery of merger benefits and this divergence generates additional pressure on integration process. Realistic mapping of expected benefits and integration timetable is as important in managing these pressures as credible communication strategies to keep the external stakeholders on board.

DUE DILIGENCE

INTRODUCTION

Due diligence is a systematic process of acquiring and analyzing information, which helps a buyer or a seller determine whether to proceed with the transaction or not.

The information obtained relates to all aspects of the business to be purchased.

It includes assimilating and processing both **quantitative information** like sales, cash flows and other financial data, and **qualitative information** like location, quality of management, internal control systems and so on.

Process of strategic analysis

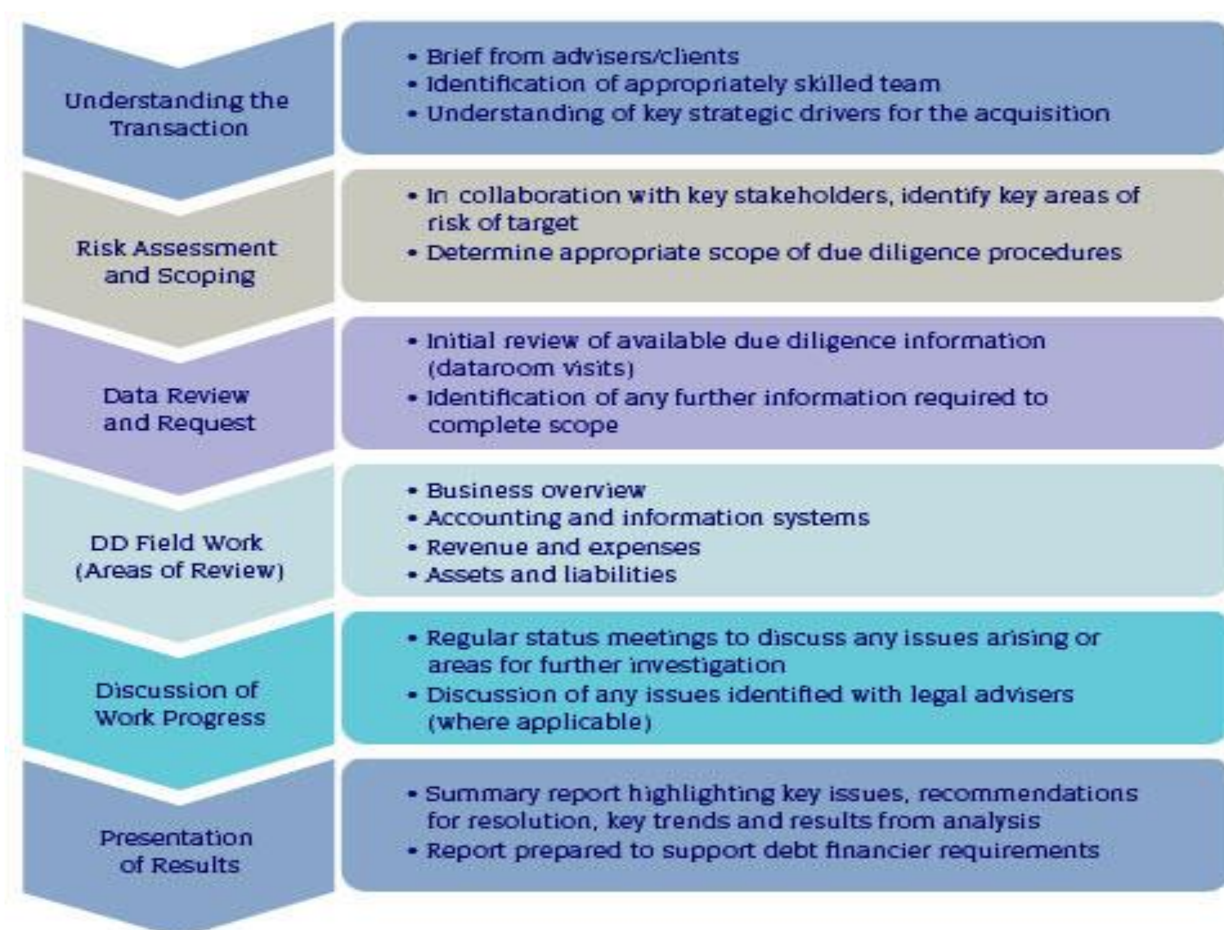
Preliminary negotiation: This leads to the execution of the letter of intent.

Due diligence: the most critical phase in the process. If its aspect is not handled properly, there can be costly surprises including broken deals.

Negotiation and signing of the definitive agreement.

Closing the transaction.

DUE DILIGENCE PROCESS



DUE DILIGENCE

- It involves analysis of public and proprietary information related to the assets and liabilities of the company being purchased.

- The information encompasses legal, tax and financial matters.
- It provides the buyer an opportunity to verify the accuracy of the information furnished by the seller.
- The process helps to determine whether there are potential concerns like questionable asset quality, title of assets, govt. approvals and so on.

DUE DILIGENCE - EXAMPLE

- One of the fiercest takeover battles in Europe was fought between Nestle and the Agnellis over the control of Perrier, a French mineral water company.
- Nestle ultimately won the battle but, to its dismay, discovered that at least one of the springs, which it thought was part of its purchase, was not owned by Perrier, to begin with (it was leased from the town).
- When queried, Perrier officials noted that they did not hide the fact, it was just that Nestle had not asked for it.

To conduct due diligence, companies typically form a team comprising of personnel from **finance, sales and marketing, human resources and tax/legal departments.** The personnel review and revise the due diligence checklist before sending it to the seller.The seller's team conducts an in-house review of all available information and lets the buyer know when, what and how any information will be provided.

A typical M&A transaction involves the preparation of a number of agreements and documents between/by the buyers and the seller. The most prominent being:

1. Non-disclosure agreement
2. Letter of intent
3. Due diligence

- Non-disclosure agreement spells out the definition of 'evaluation material' (any material or information furnished to the recipient) and the use of such material.
- The agreement prevents the buyer from using that information in an appropriate manner like public disclosure of the information (even the fact that an agreement has been signed), and it provides for the return of all the materials to the seller upon request.
- The process ends with the disclosure of the deal.

Challenges of Mergers & Acquisitions

1. **Challenges in competitive strategy planning**

Acquisitions are a mean to achieving the corporate strategy aims of improving the firm's competitive positioning in its chosen markets on a sustainable basis. An important consideration in

developing competitive strategies and business models is the expected reaction of the firm's competitors. The firms may adopt given strategies as either first movers or "me-too" followers. Both approaches have associated risks as well as opportunities. In some situations the first mover gathers the "winner-takes-all" booty but the risk of failure may be high. The second mover can reap the benefit of vicariously learning from the mistakes and failures of the first mover.

2. Challenges in Organizing for Acquisitions

A number of factors impart a momentum to acquisition decision and deal making the individual players may find difficult to control. Companies and key decision makers need to be conscious of these pressures and pulls and not allow them to over whelm the logic of the deal. Otherwise the deal will turn out to be a sub optional one and will lead to value destruction. This emphasizes the importance of establishing an acquisition function or the A Team.

The A team has a role in developing acquisition programme to deliver the strategies goals, in proactively looking for acquisition opportunities, providing internal consulting expertise to divisions, coordinating the acquisition-relative activities and developing the necessary capabilities and resources for an acquisition function that confers a competitive advantage.

In developing acquisition ideas and programmes the A team needs to consult with and coordinate all the relative functions, business units and the top mgt. Involved.

The A team has to play the devil's advocate from time to time so that over-optimistic acquisition proposals are not accepted or the acquisition process is not driven by the grandiose vision or overweening ambitions of the CEO, reducing acquisitions to a one man show.

Once the decision has been made, the bidder has to carry out deal structuring and negotiation in a way that minimizes risks not only to deal making but also to the achievement of the strategic and value creation objectives.

3. Challenges in Deal Structuring and Negotiation

There are a number of potential risks concerned with the deal-structuring and negotiation stage. Selection of an acquisition team lacking in balance of expertise from operations, laws, human resources management and other relevant functions to carry out negations or hostile bids if necessary and engaging advisers with little relevant experience or standing may lead to a costly and aborted acquisition attempt.

The A team set realistic negotiation parameters and benchmarks for negotiation but ensure that the deal-making momentum does not breach these parameters. Information is the key to successful deal making.

Inadequate due diligence and delays may lead to risk of failure of the bid as well as cost escalation in terms of the bidder managers time and organizational resources and also in terms of the costs of advisors.

The choice of experienced advisors helps to identify the deal breakers. Due diligence traditionally was restricted to accounting and legal issues. It must be extended to cover a wider range of issues including commercial and human resources due diligence.

4. Challenges in Post-acquisition Integration

The post-acquisition integration stage is intended to implement the acquisition's strategic and financial goals. In practice, there may be a 'disconnect' between the previous stages and this stage because there is a lack of continuity between the A team that developed the acquisitions strategy and guided the negotiation on the one hand and the integration teams mainly involving operations managers on the other. The disconnect may also arise from poor articulation of the strategic goals and how organizational transformation would achieve them.

There may also be lack of clarity about the new organizational structure and how the merging organization would fit into that new structure. These may give rise to fragmented perspectives and expectational ambiguity.

Merger integration may be regarded as a change process and needs to be managed by drawing upon the principles and practice of change management. Organizational change involves changes in policies of the merging organizations as well as their culture. Changing the culture of the merging firms may be necessary for the acquisitions strategic objectives. Strategy, organizational structure and organizational culture must be aligned during the integration process to deliver sustainable value creation. The integration process is fraught with uncertainty, fear and anxiety among target company staff, which may lead to withdrawal of their commitment and lack of moral.

The acquirer's implementation team must handle these concerns with tact, sympathy and understanding in order to instill confidence and trust between the two companies personnel.

The scope of integration must be carefully defined to include all important organizational functions and activities. (Such as IT systems, HR, Remuneration package, Operations & Production)

Integration may be managed as a project to integrate structure, culture, systems, processes and procedures. Task forces, transition teams and project teams may be set up to manage integration of these. Lack of project management approach to integration may result in the goals of the acquisition not being achieved, costly errors that are not spotted and corrected in good time or in costly delays.

5. Challenges in Post-acquisition Audit and Organizational learning

The audit may, if carried out, provide inadequate assessment of performance due to poor performance metrics or over-ambitious timescale for delivery of performance. As a result, there may be no clear identification of reasons for success or failure. The post acquisition audit process may also be characterized by lack of effective communication strategies to communicate the lessons from acquisitions to managers not only of business units concerned but also managers and directors concerned with acquisitions and corporate strategy.

The audit process is often regarded as a fault-finding exercised rather than as an opportunity for learning. These attitudes depend upon the culture of the organization, its openness to learning, how harsh the attitude of top management to failure is etc.

The scope of the audit often defines its quality. Some of the important issues that arise are as follows.

a. Have the deals been audited for delivering their promises?

b. Separate acquisition audit or part of normal internal audit?

c. Does the audit ensure appropriate bench marks for type of acquisition made?

d. Does the audit create a well-calibrated feedback mechanism for organization learning?

e. Are lesson from both successes and failures in acquisitions communicated effectively so they become embedded in organizational procedures, systems, cultures and routines?

OR

Manegerial Challenges of Mergers and Acquisition

Meaning of Mergers and Acquisitions:
A transaction involving two or more companies in the exchange of securities and only one company survives is called Merger.
Merger and acquisition result in several advantages in the acquiring company and the target company. There are three types of Merger. The reasons of Merger are mainly to reduce the competition, economics of scale, tax advantage, etc.

1. Scope changes – One of the rules of M & A is that change is inevitable. Managers should analyze each request and then communicate the impact of each change and the alternatives, if any exist. You can't eliminate change, but you can make your stakeholders understand how the change affects the schedule, cost, scope, and quality of the project.

2 .Failure to manage risk –

Many mergers have a list of risks, but no further analysis or planning happens unless triggered by an adverse event during merger execution. At that point, they can either act to avoid the risk through alternatives analysis, reduce the probability and/or impact with mitigation strategies, or plan a response to the risk event after it happens.

3. Insufficient team skills – The busiest people also tend to be the most highly skilled. Finding out that a team member is incompetent can be very difficult since most incompetent people do not know that they are incompetent. If one of the team member is incapable, then whole merging process will be flopped.

4. Challenges in Organizing for Acquisitions

A number of factors impart a momentum to acquisition decision and deal making the individual players may find difficult to control. Companies and key decision makers need to be conscious of these pressures and pulls and not allow them to over whelm the logic of the deal. Otherwise the deal will turn out to be a sub optional one and will lead to value destruction. This emphasizes the importance of establishing an acquisition function or the A Team.

5. Vision and goals are not well-defined– Two companies vision and mission are different, because every company should have its own objectives. After merging the manger job is to set common vision for the company.

6. Challenges in Deal Structuring and Negotiation

There are a number of potential risks concerned with the deal-structuring and negotiation stage. Selection of an acquisition team lacking in balance of expertise from operations, laws, human resources management and other relevant functions to carry out negations or hostile bids if necessary and engaging advisers with little relevant experience or standing may lead to a costly and aborted acquisition attempt.

7.Challenges in Post-acquisition Integration

The post-acquisition integration stage is intended to implement the acquisition's strategic and financial goals. In practice, there may be a 'disconnect' between the previous stages and this stage because there is a lack of continuity between the A team that developed the acquisitions strategy and guided the negotiation on the one hand and the integration teams mainly involving operations managers on the other.

8. Challenges in Post-acquisition Audit and Organizational learning

The audit process is often regarded as a fault-finding exercised rather than as an opportunity for learning. These attitudes depend upon the culture of the organization, its openness to learning, how harsh the attitude of top management to failure is etc.

Module 5: (12 Hours)

Methods of financing mergers – cash offer, share exchange ratio – mergers as a capital budgeting decision Synergies from M&A: Operating and Financial synergy

Accounting for amalgamation –amalgamation in the nature of merger and amalgamation in the nature of purchase- pooling of interest method, purchase method – procedure laid down under Indian companies act of 1956

Methods of financing mergers

Like all investments, the method of payment for mergers and acquisitions (M&A) plays a very significant role in whether or not making the investment at all is feasible. There are a number of methods available to pay for M&A, each with their pros and cons.

- **Cash/ Cash offer:** Cash is great. It's cheap compared to other methods, it's an instant transaction, and it's mess-free (meaning that once it's done, you don't have to mess with it again). The problem is that you're not talking about a small amount of cash. These sums are typically huge and not always available. Not many companies, much less individuals, carry around millions or billions in an easily accessible bank account.
- **Debt:** Debt is expensive. If you're taking out a loan or making payments over a longer period of time to the old owners, then odds are you're paying interest. This is going to increase the cost of the purchase significantly and should be taken into consideration during the pricing process. The nice part is that debt is relatively easy to come by and is more flexible than cash when it comes to repayment plans.

Here's a look at debt from another perspective. For companies that are deeply troubled, agreeing to accept the debt that the company has incurred is also an issue that can be accounted for in price. If a company is worth $100 but it owes $200 in debt, then agreeing to accept that debt will certainly lower or potentially eliminate the price of purchase.

- **Equity:** It's not unheard of to have an IPO to afford M&A. This has the same benefits and detriments as having an IPO for any other reason, except with less investor backlash. Having an IPO just for fun tends to make investors believe that the stock is overvalued and the market price will drop, making the IPO generate fewer funds and depreciating the value of existing shares.

Now, if it's done in conjunction with M&A, often investors are more forgiving or even excited about the prospect, increasing the value of the IPO and existing shares — not a bad option if your stock can handle the extra shares outstanding.

Another way to look at equity is through a stock swap. Rather than raising money through an IPO, a corporation can be bought by swapping stock. The shareholders agree to give up their shares of stock in exchange for a set number of shares of the acquiring company's stock.

For example, shareholders of Company A may receive 1.2 shares of stock from the acquiring company for every 1 share of stock they hold of the acquired company. This transition of ownership in stock is quite common for merger.

Mergers as a capital budgeting decision

Introduction:

All for-profit business seemingly exist on the mandate of maximizing shareholder, or owner, value. A business is essentially a series of transactions that aim at generating greater revenue and profits. The capital budgeting process, or the methods employed by a company to invest in activities to generate additional value, is a dynamic process, to say the least.

In a way, a business is nothing more than a series of many capital budgeting decisions. Decisions to hire a new CEO, negotiate contracts, maintain efficient operations, compete in the mergers and acquisitions arena, among others, are all capital budgeting decisions, in one way or another. Even decisions to reduce employees, shut down a division or the sale of part or all the company are capital budgeting decisions. Businesses are often observed being sold under the mandate of maximizing shareholder value.

Whether minor or major, all business decisions involve an accounting of costs versus benefits. In a way, that's the essence of the capital budgeting process. Shareholders put their trust in management to constantly assess the costs versus benefits – the risk versus the reward – of their corporate actions. When a CEO is fired, it's often because a company has failed to create shareholder value. Put another way, that CEO or executive has failed to successfully engage in value-creating projects; the capital budgeting process under that CEO was ineffective.

Understanding the capital budgeting process is not only important from an intellectual standpoint, but vital to understanding how a business can and will create future value. The world's greatest executives – Sam Walton of Wal-Mart, Roberto Goizueta of Coca Cola, Warren Buffett at Berkshire Hathaway, Jack Welch at General Electric – have a long history of making value creating decisions. These executives got capital budgeting process right.

Individual investors also benefit from the capital budgeting process. Investing in a company's stock is much like investing in a project. At a given share price, investors ought to be able to figure out if that share price is below the intrinsic value of those shares. One determines the intrinsic value by conducting a discounted cash flow analysis, essentially finding the net present value of that company. Being able to seek out undervalued investments is clearly the ultimate objective for investors and corporate executives. In one form or another, the capital budgeting process is the set of tools that facilitates that value seeking process.

Merger As a Capital Budgeting Decision

Like capital budgeting decision, merger deci-sion requires comparison between the expected benefits [measured in terms of the present value of expected benefits/cash inflows (CFAT) from the merger] with the cost of the acquisition of the target firm. The acquisition costs include the payment made to the target firm's shareholders, payment to discharge the external liabilities of the acquired firm less cash proceeds expected to be realised by the acquiring firm from the sale of certain asset(s) of the target firm. The decision criterion is 'to go for the merger' if net present value (NPV) is positive; the decision would be 'against the merger' in the event of the NPV being negative.

- Determination of Incremental Projected free cash flow to the firm(FCFF)
- Determination of Terminal value
- Determination of appropriate discount rate or cost of capital
- Determination of Present value of FCFF
- Determination of cost of acquisition

Share exchange ratio

The relative number of new shares that will be given to existing shareholders of a company that has been acquired or merged with another. After their old company shares have been delivered, the exchange ratio is used to give shareholders the same relative value in new shares of the merged entity.

An exchange ratio is designed to give shareholders an asset with the same relative value of the asset they delivered upon the acquisition of the acquired company. Relative value does not mean, however, that the shareholder receives the same number of shares or same dollar value based on current prices. Instead, the intrinsic value of the shares and the underlying value of the company will also be considered when coming up with an exchange ratio.

Synergies from M&A: Operating and Financial synergy

Synergies and merger value

In order for mergers and acquisitions to create value, cash flow of the combined entities must exceed the sum of cash flows of the individual entities before the combination. In other words, there must be synergistic cash (value) gains through the combination. From the perspective of the acquiring entity, the synergistic value gain must exceed the acquisition (takeover) premium in order that the M&A makes economic sense.

Two main types of synergy are operating synergy and financial synergy. Operating synergy comes in two forms: revenue enhancements and cost reductions. They may be derived in horizontal or vertical mergers. Financial synergy refers to the possibility that the cost of capital may be lowered by combining one or more companies.

Operating Synergy

Operating synergy is when the value and performance of two firms combined is greater than the sum of the separate firms apart and, as such, allows for the firms to increase their operating income and achieve higher growth.

Operating synergies can arise from the following:

- Economies of scale;
- Greater pricing power and higher margins resulting from greater market share and lower competition;
- Combination of different functional strengths such as marketing skills and good product line; or
- Higher levels of growth from new and expanded markets.

Operating synergies are achieved through horizontal, vertical or conglomerate mergers. Mergers of firms which have competencies in different areas such as production, research and development or marketing and finance, can also help achieve operating efficiencies.

Operating synergy is an important reason why significant premiums are sometimes paid by strategic buyers. Mid-market business owners that are approached by strategic buyers should try to quantify the operating synergies that buyers might be able to realize post-acquisition. This can go a long way to obtaining a premium valuation upon exit.

Financial Synergy

Financial synergy is when the combination of two firms together results in greater value than if they were to operate separately. Financial synergies are most often evaluated in the context of mergers and acquisitions. These type of synergies relate to improvement in the financial metric of a combined business such as revenue, debt capacity, cost of capital, profitability, etc.

Synergies related to operational metrics are referred to as operating synergies.

Examples of positive financial synergies include:

- Increased revenues through a larger customer base
- Lower costs through streamlined operations
- Talent and technology harmonies

In addition, financial synergies can result in the following benefits post acquisition:

- Increased debt capacity
- Greater cash flows

- Lower Cost of Capital
- Tax Benefits

When evaluating a merger or acquisition, the positive synergies usually produce a successful result. While financial synergies are often used with a positive connotation, these synergies can also be negative in some situations. For instance, an acquiring company may have to incur additional costs in the target company to bolster the management team or implement systems to meet the standards of the acquirer.

Although financial synergies are usually experienced by strategic buyers, a financial buyer may be willing to pay a premium for the acquisition of a mid-market business due to the benefits associated with a more efficient capital structure and lower cost of financing.

Accounting for amalgamation –amalgamation in the nature of merger and amalgamation in the nature of purchase- pooling of interest method, purchase method

Amalgamation

Definition:

Halsubury's Law of England describe amalgamation as "blending of two or more existing undertaking into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which is to carry on the blended undertaking.

There may be amalgamation either by transfer of two or more undertakings to a new company or by the transfer of one or more undertakings to an existing company.

Types of Amalgamation

The amalgamation in the nature of (i) merger or (ii) purchase.

Distinction between merger and purchase

In an amalgamation which is in the nature of merger, there is a genuine pooling not merely of the assets and liabilities of the amalgamating companies but also of the shareholders' interest and of the business of these companies. The accounting treatment of such an amalgamation should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the relevant figures of the amalgamating companies.

An amalgamation in the nature of purchase is in effect a mode by which one company acquires another company. As a consequence, the shareholders of the transferor (acquired) company normally do not continue to have a proportionate share in the equity of the transferee (acquiring) company. Actually it may not be intended to continue the business of the transferor company.

Methods of Accounting for Amalgamation

There are two methods of accounting for amalgamations, namely

(i) the pooling of interests method and (ii) the purchase method.

(i) The pooling of interests method

This method is followed in case of an amalgamation in the nature of merger. Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts and in the same form as at the date of amalgamation. The difference between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets on the one hand and the amount of share capital of the transferor company on the other hand is adjusted in reserves.

(ii) The purchase Method

This method is followed in case of an amalgamation in the nature of purchase. Under this method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities of the transferor company at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation.

The reserves of the transferor company, other than the statutory reserves, are not included in the financial statements of the transferee company. Any **excess** of the amount of the consideration over the value of the net assets of the transferor company acquired by the transferee company is recognized in the transferee company's books of account as **goodwill** arising on amalgamation. If the amount of the consideration is **lower** than the value of net assets acquired, the difference is credited to **capital reserve**

Consideration

For the purpose of accounting for amalgamation, Accounting Standard 14 (AS-14) defines the term 'consideration' as "aggregate of the shares and other securities issued and payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company". The amount depends on the terms of the contract between the transferor company and the transferee company.

Methods of Consideration

- Lump-sum Method
- Net Assets Method
- Net Payment Method
- Intrinsic Worth Method

Methods of Consideration

•Lump-sum Method

It is the simplest method. In it, the consideration is stated as a lump-sum. For example, it may be stated that P Ltd. takes over the business of S Ltd. for Rs.50,00,000. Here, the sum of Rs.50,00,000 is the consideration.

•Net Assets Method

Under this method, the consideration is arrived at by adding the agreed values of all the assets taken over by the transferee company and deducting there from the agreed values of the liabilities taken over by the transferee company. The agreed value means the amount at which the transferor company has agreed to sell and the transferee company has agreed to take over a particular asset or a liability.

•Net Payment Method

Under this method, consideration is ascertained by adding up the cash paid, agreed value of assets given and the agreed values of the securities allotted by the transferee company to the transferor company in discharge of consideration. Suppose P Ltd. for business taken over from S Ltd. agrees to pay Rs.5,00,000 in cash and allot to S Ltd. 4,00,000 equity shares of Rs.10 each fully paid at an agreed value of Rs.15 per share. In this case, the consideration will be Rs.65,00,000(5,00,000 + 60,00,000).

•Intrinsic Worth Method

Consideration may have to be calculated on the basis of the agreed value of shares of the transferor company. That consideration amount will be discharged through allotting shares of transferee company to the transferor company. Suppose P Ltd. takes over the business of S Ltd. and it is agreed between S Ltd. and P Ltd. that the value of one share of S Ltd. is Rs.13(paid up value is Rs.10 per share for 60,000 shares). Then, the consideration is Rs.13*60,000=Rs.78,00,000. This amount will be discharged through allotting shares of P Ltd. to S Ltd. One share value of P Ltd.

Is Rs.25 (paid up value is Rs.10 per share). So, P Ltd. will allot Rs.78,00,000/25=3,12,000 shares to S Ltd. This is called intrinsic worth method.

Accounting for amalgamation -procedure laid down under Indian companies act of 1956

Laws Regulating Merger

Following are the laws that regulate the merger of the company:-
(I) The Companies Act , 1956

Section 390 to 395 of Companies Act, 1956 deal with arrangements, amalgamations, mergers and the procedure to be followed for getting the arrangement, compromise or the scheme of amalgamation approved. Though, section 391 deals with the issue of compromise or arrangement which is different from the issue of amalgamation as deal with under section 394, as section 394 too refers to the procedure under section 391 etc., all the section are to be seen together while understanding the procedure of getting the scheme of amalgamation approved. Again, it is true that while the procedure to be followed in case of amalgamation of two companies is wider than the scheme of compromise or arrangement though there exist substantial overlapping.

The procedure to be followed while getting the scheme of amalgamation and the important points, are as follows:-

(1) Any company, creditors of the company, class of them, members or the class of members can file an application under section 391 seeking sanction of any scheme of compromise or arrangement. However, by its very nature it can be understood that the scheme of amalgamation is normally presented by the company. While filing an application either under section 391 or section 394, the applicant is supposed to disclose all material particulars in accordance with the provisions of the Act.

(2) Upon satisfying that the scheme is prima facie workable and fair, the Tribunal order for the meeting of the members, class of members, creditors or the class of creditors. Rather, passing an order calling for meeting, if the requirements of holding meetings with class of shareholders or the members, are specifically dealt with in the order calling meeting, then, there won't be any subsequent litigation. The scope of conduct of meeting with such class of members or the shareholders is wider in case of amalgamation than where a scheme of compromise or arrangement is sought for under section 391

(3) The scheme must get approved by the majority of the stake holders viz., the members, class of members, creditors or such class of creditors. The scope of conduct of meeting with the members, class of members, creditors or such class of creditors will be restrictive some what in an application seeking compromise or arrangement.

(4) There should be due notice disclosing all material particulars and annexing the copy of the scheme as the case may be while calling the meeting.

(5) In a case where amalgamation of two companies is sought for, before approving the scheme of amalgamation, a report is to be received form the registrar of companies that the approval of scheme will not prejudice the interests of the shareholders.

(6) The Central Government is also required to file its report in an application seeking approval of compromise, arrangement or the amalgamation as the case may be under section 394A.
(7) After complying with all the requirements, if the scheme is approved, then, the certified copy of the order is to be filed with the concerned authorities.

Module 6: (7 Hours)

Takeovers, types, takeover strategies, - Takeover defences – financial defensive measures – methods of resistance – anti-takeover amendments – poison pills

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Takeovers

Definition

Takeovers may be defined as " a transaction or series of transactions whereby an individual or group of individuals or company acquires control over the management of the company by acquiring equity shares carrying majority voting power".

➢Takeover is an acquisition of shares carrying voting rights in a company with a view to gaining control over the assets and management of the company. In takeover, the seller management is an unwilling partner and the purchaser will generally resort to acquire controlling interest in shares with very little advance information to the company which is being bought.

➢If shares totaling 51% of the total value of capital are held by the acquirer and his associates, the takeover is complete and the acquirer gets the status similar to that of a holding company.

➢Most of the corporate there exists a concept called controlling interest.

Controlling Interest

It is the proportion of the total shareholding which results in control of the administration of the company through a majority in the Board of Directors.

Types of Takeover

■Friendly Takeovers

➢In a friendly takeover, the acquirer will purchase the controlling shares after thorough negotiations and agreement with the seller.

➢The consideration is decided by having friendly negotiations.

➢The takeover bid is finalized with the consent of majority shareholders of the target company.

➢This form of purchase is also called as "consent takeover".

2. Hostile Takeovers

➢A person seeking control over a company, purchase the required number of shares from non-controlling shareholders in the open market.

➢This method normally involves purchasing of small holdings of small shareholders over a period of time at various places.

➢As a strategy the purchaser keeps his identity a secret.

➢Also called as "VIOLENT TAKEOVER".

3. Bailout Takeover

➢These forms of takeover are resorted to bailout the sick companies to allow the company for rehabilitation as per the schemes approved by the financial institutions.

➢The lead financial institutions will evaluate the bids received for acquisitions, the financial position and track record of the acquirer.

4.Reverse takeovers

A "reverse takeover" is a type of takeover where a private company acquires a public company. This is usually done at the instigation of the larger, private company, the purpose being for the private company to effectively float itself while avoiding some of the expense and time involved in a conventional IPO. However, in the UK under AIM rules, a reverse take-over is an acquisition or acquisitions in a twelve-month period which for an AIM company would:

- exceed 100% in any of the class tests; or
- result in a fundamental change in its business, board or voting control; or
- in the case of an investing company, depart substantially from the investing strategy stated in its admission document or, where no admission document was produced on admission, depart substantially from the investing strategy stated in its pre-admission announcement or, depart substantially from the investing strategy.

An individual or organization, sometimes known as corporate raider, can purchase a large fraction of the company's stock and, in doing so, get enough votes to replace the board of directors and the CEO. With a new agreeable management team, the stock is a much more attractive investment[why?], which would likely result in a price rise and a profit for the corporate raider and the other shareholders.

5.Backflip takeovers

A "backflip takeover" is any sort of takeover in which the acquiring company turns itself into a subsidiary of the purchased company. This type of takeover can occur when a larger but less well-known company purchases a struggling company with a very well-known brand. Examples include:

- The Texas Air Corporation takeover of Continental Airlines but taking the Continental name as it was better known.
- The SBC takeover of the ailing AT&T and subsequent rename to **AT&T.**
- Westinghouse's 1995 purchase of CBS and 1997 renaming to CBS Corporation, with Westinghouse becoming a brand name owned by the company.

- NationsBank's takeover of the Bank of America, but adopting Bank of America's name.

Pros and cons of takeover

While pros and cons of a takeover differ from case to case, there are a few reoccurring ones worth mentioning.

Pros:

1. Increase in sales/revenues (e.g. Procter & Gamble takeover of Gillette)
2. Venture into new businesses and markets
3. Profitability of target company
4. Increase market share
5. Decreased competition (from the perspective of the acquiring company)
6. Reduction of overcapacity in the industry
7. Enlarge brand portfolio (e.g. L'Oréal's takeover of Body Shop)
8. Increase in economies of scale
9. Increased efficiency as a result of corporate synergies/redundancies (jobs with overlapping responsibilities can be eliminated, decreasing operating costs)
10. Expand strategic distribution network

Cons:

1. Goodwill, often paid in excess for the acquisition
2. Culture clashes within the two companies causes employees to be less-efficient or despondent
3. Reduced competition and choice for consumers in oligopoly markets (Bad for consumers, although this is good for the companies involved in the takeover)
4. Likelihood of job cuts
5. Cultural integration/conflict with new management
6. Hidden liabilities of target entity
7. The monetary cost to the company
8. Lack of motivation for employees in the company being bought.

Takeovers also tend to substitute debt for equity. In a sense, any government tax policy of allowing for deduction of interest expenses but not of dividends, has essentially provided a substantial subsidy to takeovers. It can punish more-conservative or prudent management that do not allow their companies to leverage themselves into a high-risk position. High leverage will

lead to high profits if circumstances go well, but can lead to catastrophic failure if circumstances do not go favorably. This can create substantial negative externalities for governments, employees, suppliers and other stakeholders.

DEFENSIVE MEASURES

The target company takes defensive measures in order to make it unattractive or less attractive to the bidder. This would force the raider to defense himself and consequently call off his raid.

Different Kinds of Defensive Measures

1.Poison Pills

- The poison pills are often securities issued by the target firm in the form of rights offerings.
- These allow the holders to buy stock in the acquiring firm at a low price.
- They would be distributed after triggering event such as the acquisition of 20% of the stock of the target from by any individual partnership or corporation.

2. Poison put

In this case the target company can issue bonds that encourage holders to cash in at higher prices. The resultant cash drainage would make the target unattractive.

3. Greenmail

In this strategy the target company should repurchase the shares cornered by the raider.

The profits made by the raider are after all akin to blackmail and this would keep the raider at a distance from the target company.

4. Pac man defense

This strategy aims at the target company making a counter bid for the raiders company.

This would force the raider to defense himself and consequently call off his raid.

5. White knight

It is a company that comes for rescue of a firm targeted for a takeover.

➢The White Knight may make an offer to buy all or part of the target firm on more favorable terms than the original bidder and promise not to disassemble the firm or lay-off the management or other employees.

➢ It may be difficult to find a bidder willing to agree to such restrictive terms and some compromise by the target firm may have to be entertained.

➢ Generally search for a White Knight begins immediately a bid is launched.

6. White squire defense

➢It is similar to White Knight defense, in that two parties, target firm and white squire; seek to implement a strategy to preserve the target firm's independence.

➢This is done by placing assets or shares in the hands of a friendly firm or investor who is not interested in acquiring control of the target firm and will not sell-out to a hostile bidder.

➢This is rarely a long-term solution as the white squire often sells on the shares or becomes a gray knight I.e. makes a hostile bid himself.

7. Golden parachutes

➢These are unacceptably high compensation packages that must be paid to managers if they are forced to leave the firm.

➢Managers have five or ten-year contracts with provisions for full payments up-front if they are forced to leave.

8. Crown jewels lock up

➢This is a contract to sell the firms valuable assets at below market price if the hostile bid succeeds.

9. Asset restructuring

➢The target company can sell assets that the bidder wants to another company.

➢This action makes the target company less desirable to the bidder.

10. Standstill agreement

➢It occurs when the target firm reaches a contractual agreement with the potential bidder that he will not increase his holdings in the target firm for a particular period.

➢The agreement can take many forms, including the right first refusal to the target firm if the bidder sells his shares and a commitment by the bidder not to increase his holdings beyond a certain percentage in return for a fee. Stand still agreements are frequently accompanied by greenmail.

11. Shark repellents

➢The shark repellents are designed to make the target firm so unpleasant that it is attack-proof.

➢They could include super majority provisions, I.e.80% approval required for a merger, staggered board elections, fair price provisions to determine the price of minority shareholders stock and dual capitalization, whereby the equity is restricted into two classes with different voting rights.

DEFENSIVE MEASURES IN HOSTILE TAKEOVER BIDS

The defensive strategies used against anti takeover bids are classified into-

1. Preventive measures
2. Active measures

Preventive anti-takeover measures:

The presence of certain characteristics like the strong and stable cashflows, low levels of debt in the capital structure, low stock price compared to the value of the firms assets, etc., make a firm vulnerable to a takeover. Hence some preventive measures are adopted to adjust to these characteristics of the firm, so that the financial motivation of a bidder to acquire the target firm is reduced to a large extent. Through these measures the pace of the takeover attempt can be slowed down and the acquisition becomes more expensive for the bidder. The following are some anti-takeover defenses.

i. Poison Pills-

The poison pills are often securities issued by the target firm in the form of rights offerings to its Share holders to make the firm less valuable in the eyes of a hostile bidder.these shares have no value till the happening of a triggering event(acquisition of certain percentage of the firm’s voting stock by the bidder.). These allow the holders to buy stock in the acquiring firm at a low price. They would be distributed after triggering event such as the acquisition of 20% of the stock of the target from by any individual partnership or corporation. The strategy involves issue of low price preferential shares to enlarge the capital base; this would make the hostile takeover too expensive.

Example: Long term contracts, provisions for withdrawing from contracts if control shifts.

ii. Poison puts

In this case the target company can issue bonds that encourage holders to cash in at higher prices.The bonds issued contain put option which allows the holders to exercise in the event of a hostile takeover. This allows the bond holders to demand repayment of the amount in the event of hostile takeover. The resultant cash drainage would make the target unattractive.

iii. People pill

Sometimes the entire management teams threatens to resign, in the event of a takeover. This threat is especially useful if the existing management team is a good team. Losing the team could seriously impact the company's performance and hence may discourage the raider to really attempt a takeover.

iv. Shark Repellents or Super majority provisions

➢The shark repellents are designed to make the target firm so unpleasant that it is attack-proof.

➢They could include super majority provisions, i.e.80% approval required for a merger, staggered board elections, fair price provisions to determine the price of minority shareholders stock and dual capitalization, whereby the equity is restricted into two classes with different voting rights. In extreme cases, amendments have provided as high as 95% of the votes for merger approval.

v. Dual capitalization

Here the Board of Directors creates a new class of securities with special voting rights. This voting power is given to a group of stockholders who are friendly to the management. A typical dual capitalization involves the issuance of another stock that has superior voting rights to all the current outstanding stock holders. The stockholders are given the right to exchange this stock for ordinary stock. The stockholders prefer to exchange the super voting stock to the ordinary stock because the former usually lack marketability and also fetch low dividends. Management retains the special voting stock. This result in the management increasing its voting control of the corporation.

vi. Golden Parachutes

➢These are unacceptably high compensation packages that must be paid to managers if they are forced to leave the firm. The term 'golden' is used because of the attractive compensation that executives covered by these agreements receive.

➢Managers have five or ten-year contracts with provisions for full payments up-front if they are forced to leave.

➢A golden parachute agreement provides for lump sum payments to certain senior management either voluntary or involuntary termination of their employment. This agreement is usually effective if termination occurs within one year after the change in control.

vii. Silver Parachutes

This is just like golden parachute but given to lower level managers. It is also compensation payable to an employee when he is terminated but it is small amount.

viii. Staggered or Classified Board

The directors of a firm is divided into a number of different classes. Only one class is up for re-election each year. These leads to delay in the effective transfer of control in takeover.

For ex: Board of Directors consisting of 12 members can be divided into 3 groups, with only one group up for election in a particular year. Hence, the hostile bidder has to wait for 2 or more annual general meetings to gain control of the board in spite of holding the majority of the stock. The size of the board is also limited to prevent the stockholders from simply adding the board seats to take control of the board.

Active anti-takeover Measures:

I. White Knight

It is a company that comes for rescue of a firm targeted for a takeover.

- The White Knight may make an offer to buy all or part of the target firm on more favorable terms than the original bidder and promise not to disassemble the firm or lay-off the management or other employees.
- It may be difficult to find a bidder willing to agree to such restrictive terms and some compromise by the target firm may have to be entertained.
- Generally search for a White Knight begins immediately a bid is launched.

II. White Squire defense

- It is similar to White Knight defense, in that two parties, target firm and white squire; seek to implement a strategy to preserve the target firm's independence.
- This is done by placing assets or shares in the hands of a friendly firm or investor who is not interested in acquiring control of the target firm and will not sell-out to a hostile bidder.
- This is rarely a long-term solution as the white squire often sells on the shares or becomes a gray knight I.e. makes a hostile bid himself.

III. Green Mail

In this strategy the target company should repurchase the shares cornered by the raider.

The profits made by the raider are after all akin to blackmail and this would keep the raider at a distance from the target company.

Greenmail refers to the buying back of shares at a substantial premium from the stockholders holding a significant majority shares in return for an agreement that he will not initiate bid for control of the company.

Greenmail refers to an incentive offered by management of the target company to the potential bidder for not pursuing the takeover. The management of the target company may offer the acquirer for its shares a price higher than the market price. The potential acquirer is required to sign an agreement called standstill agreement whereby he undertakes not to begin a bid for control of the company.

IV. Standstill Agreement

➢It occurs when the target firm reaches a contractual agreement with the potential bidder that he will not increase his holdings in the target firm for a particular period.

➢The agreement can take many forms, including the right first refusal to the target firm if the bidder sells his shares and a commitment by the bidder not to increase his holdings beyond a certain percentage in return for a fee. Stand still agreements are frequently accompanied by greenmail.

V. Pac man Defense

This strategy aims at the target company making a counter bid or tender offer for the raiders company or acquiring company.

This would force the raider to defense himself and consequently call off his raid.

VI. Asset restructuring

➢The target company can sell assets that the bidder wants to another company.

➢This action makes the target company less desirable to the bidder.

VII. Crown Jewels Lock up

➢This is a contract to sell the firms valuable assets at below market price if the hostile bid succeeds. It is based on the agreement that a particular asset of the firm is so highly valued that it attracts raider. The asset may be a highly profitable division, an undervalued fixed asset or an intangible asset like brand or patent. When a target company uses the tactic of divesture it is said to sell the crown jewels.

VIII. Divesture

In a divesture, the target company divests of spin off some of its businesses in the form of an independent subsidiary firm. Thus it reduces the attractiveness of he existing business to the acquirer.

IX. Share Repurchase

This involves buying back its own shares from the public. This is a sound strategy and has several advantages:

The number of shares available to the raider is reduced. Once the target acquires certain shares, these shares will no longer be available for the bidder to purchase.

HOSTILE TAKEOVER APPROACHES

- A hostile takeover allows a suitor to take over a target company's management unwilling to agree to a merger or takeover.
- A takeover is considered "hostile" if the target company's board rejects the offer, but the bidder continues to pursue it, or the bidder makes the offer without informing the target company's board **beforehand**.
- A hostile takeover can be conducted in several ways. A tender offer can be made where the acquiring company makes a public offer at a fixed price above the current market price.
- An acquiring company can also engage in a proxy fight, whereby it tries to persuade enough shareholders, usually a simple majority, to replace the management with a new one which will approve the takeover
- Another method involves quietly purchasing enough stock on the open market, known as a creeping tender offer, to effect a change in management. In all of these ways, management resists the acquisition but it is carried out anyway.
- The main consequence of a bid being considered hostile is practical rather than legal. If the board of the target cooperates, the bidder can conduct extensive due diligence into the affairs of the target company.
- It can find out exactly what it is taking on before it makes a commitment. But a hostile bidder knows only publicly- available information about the target, and so takes a greater risk.
- Also, banks are less willing to back hostile bids with the loans that are usually needed to finance the takeover.

Advantages to the acquirer company

- The acquirer is benefited by way of reduction in procurement costs and operational synergies resulting in improved margins.
- The acquirer is able to acquire new technology and add to its manufacturing capacities.
- The acquirer is able to increase its market share and acquire new brands.

Disadvantages for the acquirer company

- Studies have revealed that returns to the shareholders of the acquirer company are mminimal. Minorityshare-holders of the acquirer company may not be in favour of deployment of funds towards acquisition since there could be no direct benefits flowing.
- Secondly, the acquiring company may offer hefty premiums to ensure the success of its bid. Such inflated prices are generally unjustified and unsubstantiated by sound reasoning since there is a 'blind rush' to acquire.
- Thirdly, the acquirer company could face financial hazards like 'hidden liabilities'and valuation pitfalls.

Module 7: (8 Hours)

Legal aspects of Mergers/amalgamations and acquisitions/takeovers- Combination and Competition Act- Competition Commission of India (CCI)- CCI Procedure in Regard to the transactions of Business Relating to combination of Regulations 2011- Scheme of Merger/Amalgamation-essential features of the scheme of amalgamation-Approvals for the scheme-Step wise procedure- Acquisitions/Takeovers- Listing agreement-The SEBI Substantial Acquisition of Shares and Takeover code.

Legal aspects of Mergers/amalgamations and acquisitions/takeovers:

Combination and Competition Act

Background :-The Government of India (GOI) have issued notifications on 4 March 2011 to bring into force, from 1 June 2011, the provisions of sections 5, 6, 20, 29, 30 and 31 of the Competition Act 2002 (the Act). Section 5 of the Act contains provisions relating to "Combination" and Section 6 of the Act contains provisions relating to "Regulations of Combinations".

Sections 20, 29, 30 and 31 of the Act contain procedural provisions relating regulations of the Combination. GOI has, in consultation with the Competition Commission of India (CCI) – the regulator appointed under the Act – enhanced by 50% the threshold of monetary limit of "assets" and "turnover" under Section 5 of the Act for reckoning 'Combination'.

Meaning of Combination

As per the Act, a 'Combination' comprises of any of the following –

- Any acquisition of – control / shares / voting rights / assets of enterprises
- acquiring of control by person over an enterprises, where such person already has direct / indirect control over another enterprise engaged in similar / competitive business
- Any merger or amalgamation between enterprises if it exceeds the monetary threshold of assets and or turnover as under:

Person/ Enterprise	Rs.		USD / Rs.	
	In India		In or Outside India	
	Assets*	Turnover	Assets*	Turnover
Acquirer + Target	> 15 billion	> 45 billion	USD > 750 mn Including at least Rs. 7.50 billion should be in India	USD > 2.25 billionIncluding at least Rs. 22.50 billion should be in India

^Group post acquisition	> 60 billion	> 180 billion	USD > 3 billion Including at least Rs. 7.50 billion should be in India	USD > 9 billion Including at least Rs. 22.50 billion should be in India

* Assets – book value as per audited accounts and includes intangibles ^ Group means two or more enterprises, which directly or indirectly –

- Exercise => 26% of voting rights in other enterprise
- Appoint > 50% of board members in other enterprise
- Control (#) the management or affairs of the other enterprise

Control include controlling the affairs or management, either singly or jointly:

- By one or more enterprises over another enterprise or group; or
- By one or more groups over another group or enterprise

As mentioned above, GOI has enhanced the monetary limit of "assets" and "turnover" under section 5 of the Act. The above table is after considering such enhancement.

Exemptions from Section 5 of the Act:

1. An enterprise, whose control, shares, voting rights or assets are being acquired has assets of the value of not more than ~ 2.50 billion or turnover of not more than ~ 7.50 billion is exempted from the provisions of Section 5 of the Act for a period of 5 years from 4 March 2011.

2. A 'Group' exercising less than 50% of voting rights in other enterprise is exempted from the provisions of Section 5 of the Act for a period of 5 years from 4 March 2011.

Overview of Regulation of Combination

Section 6 of the Act inter alia provides that no person or enterprise shall enter into a Combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

If any proposed Combination exceeds the threshold of assets and / or turnover specified in Section 5 of the Act (as aforesaid), the person / enterprise need to intimate the same to the CCI within 30 days of board approval / entering into of the agreement for Combination for approval.

A Combination cannot come into effect until a period of 210 days has passed from the day on which the notice was given to CCI or CCI has passed an order under Section 31 of the Act, whichever is earlier.

Above mentioned requirement of obtaining approval of CCI for the combination is not applicable to share subscription/ financing facility or any acquisition by public financial institution, Foreign Institutional Investor (FII), Venture Capital Fund, Bank pursuant to any covenant of a loan / investment agreement.

Under section 31 of the Act, broadly if the CCI opines that the combination

- Does not or is not likely to have an appreciable adverse effect on competition, it would order approval of the combination.
- Is or is likely to have an appreciable adverse effect on competition, it would order that the combination shall not take effect.
- Is or is likely to have an appreciable adverse effect on competition but such an adverse effect can be eliminated by suitable modification of such combination, the CCI may suggest appropriate modification to the combination for approval by the parties. CCI, in such case would pass appropriate order based on response received from the parties to the Combination.

Conclusion:-On and from 1 June 2011, any acquisition or merger or amalgamation that exceeds the monetary threshold specified in Section 5 of the Act will require approval of CCI. These provisions are aimed at ensuring that the proposed Combination is not anti-competitive. This may lengthen the time required to complete the Combination. If CCI is convinced that the Combination is not anti-competitive, it should not be difficult to obtain the approval. The CCI has also released draft rules for public comments on provisions relating to Regulations of Combinations. Once this is finalized and notified, it will facilitate implementation of the provisions relating to Combination

The Competition Act ,2002

Following provisions of the Competition Act, 2002 deals with mergers of the company:- (1) Section 5 of the Competition Act, 2002 deals with "Combinations" which defines combination by reference to assets and turnover

(a) Exclusively in India and

(b) in India and outside India

For example, an Indian company with turnover of Rs. 3000 crores cannot acquire another Indian company without prior notification and approval of the Competition Commission. On the other hand, a foreign company with turnover outside India of more than USD 1.5 billion (or in excess of Rs. 4500 crores) may acquire a company in India with sales just short of Rs. 1500 crores without any notification to (or approval of) the Competition Commission being required. (2) Section 6 of the Competition Act, 2002 states that, no person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

All types of intra-group combinations, mergers, demergers, reorganizations and other similar transactions should be specifically exempted from the notification procedure and appropriate clauses should be incorporated in sub-regulation 5(2) of the Regulations. These transactions do not have any competitive impact on the market for assessment under the Competition Act, Section 6.

Competition Commission of India (CCI)

The Competition Commission of India (CCI) was established under the Competition Act, 2002 for the administration, implementation and enforcement of the Act, and was duly constituted in March 2009. The following are the objectives of the Commission.

1. To prevent practices having adverse effect on competition.

2. To promote and sustain competition in markets.

3. To protect the interests of consumers and

4. To ensure freedom of trade

Consequent upon a challenge to certain provisions of the Act and the observations of the Hon'ble Supreme Court, the Act was amended by the Competition (Amendment) Act, 2007. The Monopolies and Restrictive Trade Practices Act, 1969 [MRTP Act] repealed and is replaced by the Competition Act, 2002, with effect from 01st September, 2009 [Notification Dated 28th August, 2009].

Competition Commission of India is a body of the Government of India responsible for enforcing The Competition Act, 2002throughout India and to prevent activities that have an adverse effect on competition in India. It was established on 14 October 2003. It became fully functional in May 2009 with Dhanendra Kumar as its first Chairman.

CCI Procedure in Regard to the transactions of Business Relating to combination of Regulations 2011

The Competition Commission of India ("CCI") has amended the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (Combination Regulations). A notification in respect was issued by the CCI on March 28, 2014.

Whilst the latest amendment has various interesting changes from a practical and commercial perspective, the biggest and most important amendment that the notification specifies is the fact that the CCI has tightened its rules to ensure that companies do not escape its scrutiny through innovative structuring of mergers and acquisitions.

Set out below is an overview of the aforementioned amendment, along with the other amendments envisaged under the amended Combination Regulations:

(a) **Filing of a combination notification to be determined by the substance /intent of transactions**

The CCI has clarified that the requirement for the filing of a combination notification shall be determined by the substance / intent of transaction, thereby rendering the structuring of the transaction moot. This amendments seeks to ensure that the parties to a combination do not avoid seeking mandatory premerger approval by adopting innovative and complex structures to their transactions. Accordingly, howsoever a transaction may be structured, the CCI has clarified that

as long as the proposed combination exceeds the applicable thresholds, the parties will need to take prior approval from the CCI, before consummating such transaction.

(b) **Notification in relation to transactions taking place outside of India**

The Combination Regulations, under Schedule I thereof, provide a list of transactions that normally do not require prior notification and approval from the CCI since the same are treated as not having an appreciable adverse effect on competition in India. One such transaction that is viewed 'not having an appreciable adverse effect on competition in India' is a transaction that takes place entirely outside India with insignificant local nexus and effect on markets in India. Per the notification, this clause has been deleted.

The said clause had been a bone of contention for quite a while since both, section 5 of the Competition Act, 2002 ('Act') as well as the Target Exemption (introduced by the Central Government vide section 54(a) of the Act), provided for local nexus – i.e. minimum assets or turnover that the parties should have in India before they are subjected to the requirement of prior approval from the CCI. Thus, there was some confusion as to what additional criteria was sought under the (now deleted) clause in the Combination Regulations. In fact, this lack of clarity was a point of contention in the case of Tata Chemicals Limited – Wyoming (Combination Registration No. C-2011/12/12), where the CCI opined that "the parties to the proposed combination meet the thresholds relating to assets and turnover in India as mentioned in Section 5(c) of the Act, and one of the parties to the proposed transaction is in India".

(c) **Amendment to Form I and Form II**

(i) Form I (short form filing): Per the notification, the CCI now requires wider disclosure of any horizontal overlap or vertical relationships between the businesses of the parties to the transaction. Moreover, the parties will now be required to provide details of merger filings made by the parties in other jurisdictions, along with the status report of such filings.

(ii) Form II (long form filing): Per the notification, the CCI will now require the parties to provide the details, in terms of value of assets and aggregate of turnover, as per the audited annual accounts of immediately preceding two (2) financial years, instead of the immediately preceding financial year.

(d) Increase in filing fee

The fee for filing forms by enterprises has been increased. The fee for filing Form I under various combinations has been hiked to INR 15 1,500,000 (approximately USD 25,000) from INR 1,000,000. Further, the fee for submitting Form II has also been increased to INR 5,000,000 (approximately USD 83,000) from INR 4,000,000.

(e) Right of appeal

The CCI has now deleted Regulation 29 (of the Combination Regulations). The erstwhile Regulation 29 allowed parties to the proceedings to prefer an appeal against an order of the CCI relating to combinations to the Competition Appellate Tribunal ('COMPAT'). The CCI has clarified that Regulation 29 was unnecessary given the statutory right to appeal provided under

section 53B of the Act. Whereas Regulation 29 only allowed a "party to the proceedings" to prefer an appeal, Section 53B of the Act confers a right on "any person" to appeal against an

order of the CCI in respect of combinations.

Having said that, however, the COMPAT has, vide its Order dated March 27, 20141, reviewed the issue of locus standing in some detail and has limited the scope of this right.

Final Words

The amendments will have significant impact on the manner in which combinations would be structured in India, going forward as the 'substance over form' amendment would mean that in any transaction where there is a change of control or one party is able to influence the strategic decisions of the other through contract or otherwise, such transactions will have to be notified to the CCI.

Additionally, with the deletion of the "local nexus" entry, there will be a lesser chance of transactions going unreported to the CCI with the parties being under the mistaken belief that their transaction could benefit from the exemption in relation to the 'local nexus' provision.

Mergers/Amalgamations

The terms merger and amalgamation are used interchangeably as a form of business organization to seek external growth of business. A merger is a combination of two or more firms in which only one firm would survive and the other would cease to exist, its assets / liabilities being taken over by the surviving firm. An amalgamation is an arrangement in which the assets / liabilities being taken over by the surviving firm. An amalgamation is an arrangement in which the assets / liabilities of two or more firms become vested in another firm. As a legal process, it involves joining of two or more firms to form a new entity or absorption of one/ more firms with another. The outcome of this arrangement is that the amalgamating firm is dissolved / wound-up and loses its indenting and its shareholders become shareholders of the amalgamated firm. Although the merger / amalgamation of firms in India is governed by the provisions of the companies Act, 1956, it does not define these terms. The Income Tax Act, 1961, stipulates two pre-requisites for any amalgamation through which the amalgamated company seeks to avail the benefits of set-off / carry forward of losses and unabsorbed depreciation of the amalgamating company against its future profits under Section 72-A, namely,

i. all the property and liabilities of the amalgamated company / companies immediately before amalgamation should vest with / become the liabilities of the amalgamated company and

ii. The shareholders other than the amalgamated company / its subsidiary (ies) holding at least 90 percent value of shares / voting power in the amalgamating company should become shareholders of the amalgamated company by virtue of amalgamation. The scheme of merger, income tax implications of amalgamation and financial evaluation are discussed in this section.

Scheme of Merger / Amalgamation

Wherever two/ more companies agree to merge with each other, they have to prepare a scheme of amalgamation. The acquiring company should prepare the scheme in consultation with its merchant banker(s) / financial consultants. The main contents of a model scheme, inter-alia, are as listed below.

- Description of the transfer and the transferee company and the business of the transferor.
- Their authorized, issued and subscribed / paid –up capital.
- Basis of scheme : Main terms of the scheme in self-contained paragraphs on the recommendation of valuation report, covering transfer of assets / liabilities, transfer date, reduction or consolidation of capital, application to financial institutions as lead institution for permission and so on.
- Change of name, object clause and accounting year.
- Protection of employment.
- Dividend position and prospects.
- Management : Board of directors, their number and participation of transferee company's directors on the board.
- Application under section 291 and 394 of the Companies Act, 1956, to obtain Higher Court's approval.
- Expenses of amalgamation.
- Conditions of the scheme to become effective and operative, effective date of amalgamation.

The basis of merger / amalgamation in the scheme should be the reports of the valuers of assets of both the merger partner companies. The scheme should be prepared on the basis of the valuer's report, reports of chartered accountants engaged for financial analysis and fixation of exchange ratio, report of auditors and audited accounts of both the companies prepared up to the appointed date. It should be ensured that the scheme is just and equitable to the shareholders, employees of each of the amalgamating company and to the public.

Essential Features of Scheme of Amalgamation: The essential features r pre-requisites for any scheme of amalgamation are as enumerated below.

- **Determination of Transfer Date (Appointed Date) :** This involves fixing of the cut-off date from which all properties, movable as well as immovable and rights attached thereto are sought to be transferred from amalgamating company to the amalgamated company. This date is known as transfer date or the appointed date and is normally the first day of the financial year preceding the financial year for which the audited accounts are available with the company.
- **Determination of Effective Date** by when all the required approvals under various statutes, viz, the Companies Act 1956. The Companies (Court) Rules 1959, Income Tax

Act, 1961. Sick Industrial Companies (Special Provisions) Act, 1985, would be obtained and the transfer and vesting of the undertaking of amalgamating company with the amalgamated company would take effect. This date is called effective date. A scheme of amalgamation normally should also contain conditions to be satisfied for the scheme to become effective.

The effective date is important for income tax purposes the Companies Act does not provide for such a date but it is a practical necessity so that a court passing an order under Section 394(2) dealing with vesting of properties in the transferee company has before it a meaningful date contained in the scheme serving the purpose and in the contemplation of the applicant companies who are free to choose any date which will be binding one. While sanctioning the scheme the court also approves this date. The effective date may be either retrospective or prospective with reference to the application to the court. The effect of the requirement is that a mere order for the transfer of the properties / assets and liabilities to the transferee company would cause the vesting only from the date of that order. For tax considerations, the mention in the order of the date of vesting is of material consequences.

i. The scheme should state clearly the arrangements with secured and unsecured creditors including the debenture – holders.
ii. It should also state the exchange ratio, at which the shareholders of the amalgamating company would be offered shares in the amalgamated company. The ratio has to be worked out based on the valuation of shares of the respective companies as per the accepted methods of valuation, guidelines and the audited accounts of the company.
iii. The scheme should also provide for transfer of whole or part of the undertaking to the amalgamated company, continuation of level proceedings between the amalgamating and the amalgamated companies, absorption of employees of the amalgamating company, obtaining the consent of dissenting shareholders and so on.

- **Approvals for the Scheme**

The scheme of merger / amalgamation is governed by the provisions of Section 391-394 of the Companies Act. The legal process requires approval to the schemes as detailed below.

- **Approvals from Shareholders** In terms of Section 391, shareholders of both the amalgamating and the amalgamated companies should hold their respective meetings under the directions of the respective high courts and consider the scheme of amalgamation. A separate meeting of both preference and equity share holders should be convened for this purpose. Further, in terms of Section 81(1A), the shareholders of the amalgamated company are required to pass a special resolution for issue of shares to the shareholders of the amalgamating company in terms of the scheme of amalgamation.
- **Approval from Creditors / Financial Institutions / Banks**

Approvals are required from the creditors, banks and financial institututions to the scheme of amalgamation in terms of their respective agreements/ arrangements with each of the amalgamating and the amalgamated companies.

- Approvals are required from the creditors, banks and financial institutions to the scheme of amalgamation in terms of their respective agreements / arrangements with each of the amalgamating and the amalgamated companies as also under Section 391. **Approval from Respective High Court(s)**

Approvals of the respective high court(s) in terms of Section 391-394, confirming the scheme of amalgamation are required. The courts issue orders for dissolving the amalgamating company without winding-up on receipt of the reports from the official liquidator and the regional director, Company Law Board, that the affairs of the amalgamating company have not been conducted in a manner prejudicial to the interests of its members or to public interests.

Step-wise procedure for amalgamation.

Now let us discuss step-wise procedure for amalgamation.

Object Clause

The first step is to examine the objects clauses of the memorandum of association of the transferor and the transferee companies so as to ascertain whether the power of amalgamation exists or not. The objects clause of transferee company should allow for carrying on the business of the transferor company. If it is not so, it is necessary to amend the objects clause. Similarly, it should be ascertained whether the authorized capital of the transferee company would be sufficient after the merger / amalgamation. If is not so, this clause should also be amended. Suitable provisions for these could be incorporated in the scheme itself.

Preparation of a scheme of amalgamation on the lines explained earlier.

Meetings / Information

i. Holding of meeting of the board of directors of both the transferor and the transferee companies (a) to decide the appointed date and the effective date, (b) to approve the scheme of amalgamation and exchange ratio and (c) to authorize directors / officers to make applications to the appropriate high court for necessary action
ii. Inform the stock exchanges concerned about the proposed amalgamation immediately after the board meetings.
iii. The shareholders and other members of the companies should also be informed through press release.
iv. The transferor the and transferee companies should inform the financial institutions, bankers / debenture- trustees at least 45 days before the board

meeting so that their approval is available to the proposed amalgamation at the time of board meeting.

Application for Amalgamation

An application for amalgamation can be submitted by the company, members or even any of the creditors. A member, in this context means any person who has agreed to be a member and whose name appears on the register of members. A creditor includes all persons having pecuniary claims against the company for some amount whether present or future, definite or contingent. Even one member or one such creditor can make an application for amalgamation. Where the application is proposed to be made by the company, only a person authorized by the company in this behalf can make an application for amalgamation. It is, therefore, essential that the company should authorize the director(s) or other officer (s) to make an application to the appropriate high courts and take necessary action as may be required from time to time. The directors can, however, apply for amalgamation only when requisite power appears in the articles of association originally or by way of amendment. Separate applications under Section 291 are required to be submitted to the appropriate high courts by the amalgamating and the amalgamated companies for the purpose of the respective high courts issuing directions to convene meetings of shareholders separately for preference and equity shareholders to approve the scheme of amalgamation. It is incumbent on both the transferor and the transferee companies to obtain sanction of high courts having jurisdiction over them. However, where both the companies are under the jurisdiction of the same high court, a joint-application may be made. Such an application can be moved even when an order for winding up has been made. However, the transferee company need not obtain approval under Section 391 when the transferor company is a whollyowned subsidiary of the transferor company.

Procedure for Application to the High Court

The procedure for making application to the high court has been laid down under the Companies (Court) Rules, 1959. An application under section 391 (1) for an order convening a meeting of creditors and/or members or any class of them should be by a judge’s summons supported by an affidavit. A copy of the proposed compromise or arrangement should be annexed to the affidavit as an exhibit. The summons should be moved ex parte. Where the company is not the applicant, a copy of the summons and of the affidavit should be served on the company, or where the company is being wound-up, on its liquidator, not less than 14 days before the date fixed for the hearing of the summons. On receipt of the application by the high court, a hearing takes place in the judge’s chamber, and after the hearing the judge may either dismiss the summons or order a meeting of the members or may give such directions as he may think necessary. But it is incumbent on the court to be satisfied that prima facie the scheme is genuine, banafide and largely in the interest of company and its members. On being not satisfied with the scheme, the court may not even order the calling of

meeting of creditors even if the consent of the creditors has been withheld or malafide or arbitrary even if the court considers the scheme reasonable and beneficial to the creditors. The court may dispense with the requirement of convening a meeting where all the members of a particular class have consented to the scheme and have entered into necessary agreement with the transferee company. Having known. Having known the proposed meeting the creditors may also move the court for rejection of the scheme and the court may entertain such an application and after reasonable scrutiny may call off the meeting.

Holding of Meeting

The next step is to hold separate meetings of the shareholders and creditors of the company to seek approval to the scheme. The resolution approving the scheme may be passed by voting in person or by proxy as per the directions of the high court. At least three-fourth in value of the members or class of members or creditors must vote in favour of the resolution approving the scheme of amalgamation.

The members and the creditors are required to be classified into different classes for the purpose of convening meetings. This process has to be followed immediately on receipt of application under section 391 (1). If meetings of incorrect classification are convened and objection is taken with regard to any particular creditor of having interest competing with others, the company runs the risk of the scheme being dismissed. After classification, the court may order convening of the respective meetings of members and/or creditors.

For the purpose of convening meetings the court may give directions as it may deem fit regarding the following :

i. Fixing the time and place of such meetings(s);
ii. Determining the class or classes of creditors and/or members have to be held for considering the proposed compromise or arrangement;
iii. Appointing a chairman or chairmen for the meeting(s) to be held, as the case may be;
iv. Fixing the quorum and the procedure to be followed at the meeting(s) including voting by proxy;
v. Determining the values of creditors and/or the members of any class, as the case may be, whose meetings have to be held;
vi. Notice to be given of the meeting(s) and the advertisement of such notice;
vii. The time within which the chairman of the meeting is to report to the court the results of the meeting; and such other matters as the court may deem necessary.

The notice of the meetings of members and/or creditors, should be:

a. sent to the members / creditors;

b. sent to them individually by the chairman appointed for the meeting or if the court so directs, by the company or any other person as the court may direct, by post under certificate of posting to the last known address at least 21 clear days before the date of the meeting;

c. accompanied by a copy of the proposed scheme of compromise or arrangement and of the statement required to be furnished under section 393 and also a form of proxy.

The approval of the registrar of the appropriate high court should be obtained in respect of notice and explanatory statements, specifying the particulars prescribed under section 393 and in accordance with the directions issued by the court. The notice of the meeting must be advertised in the prescribed form in such paper(s) as the court may direct, not less than 21 clear days before the date fixed for the meeting. In case of default, the summons should be posted before the court for such orders as it may think fit to make.

Report of Chairman to the Court The chairman of the meeting must within the time fixed by the court or where no time is fixed within 7 days of the date of the meeting, report the result of the meeting to the court. The report should state accurately the number of creditors or class of creditors or the numbers of members or class of members, as the case may be, who were present and who voted at the meeting either in person or by proxy, their individual values and the way the voted.

Presenting Petition Before the Court

After the proposed scheme is agreed to with or without modification in terms of section 391(2), the company must within seven days of the filing of the report by the chairman, present a petition to the court for confirmation of the compromise or arrangement. A copy of the petition should also be submitted to the regional director, company law board and others as directed by the court. The court would not sanction a scheme simply because it is recommended by the board of directors and approved by a statutory majority of the company. The court would have to see itself whether the scheme is reasonable and fair to all parties. A scheme which is proper on the face of it and in respect of which no fraud is alleged would not be rejected unless the objector shows any valid ground against it.

Under Section 394 (A), the court should give notice of every application made to it under Section 391 or 394 to the central government/regional directors of company law board and take into consideration the representations, if any, made to it by the government before passing any order. However, the court is not bound to go by the opinion of the government / regional director as to the matters of public interest; rather it can form its independent opinion over the matter.

Where the company fails to present the petition for confirmation of the proposed scheme, it is open to any creditor or contributory, with the leave of the court, to present the petition and the company would be liable for cost. Where no such petition

is presented for confirmation, the report of the chairman as to the result of the meeting must be placed for consideration before the judge for such orders as may be necessary. Such a petition must be moved within 7 days of the filling of the report by the chairman.

Once the scheme has been approved by the members of a company in a duly convened and held meeting, the petition filed for confirmation of the same cannot be withdrawn. The only course of action that may be followed is to appear before the court and raise the objections when the scheme comes up for consideration. In such a case, the scheme may not be sanctioned and the court may order for holding meetings of the members again. However, there is nothing to prevent a company from requisitioning a meeting to consider a proposed modification in the scheme.

The court would fix a date for hearing of the petition and a notice of the hearing must be advertised in the same newspapers in which the notice of the meeting was advertised or in such other papers as the court may direct not less than 10 days before the date fixed for the hearing.

The order of the court on the petition confirming the scheme should contain such directions in regard to any matter and such modifications in regard to compromise or arrangement as the judge may think fit to make for the proper working of the compromise or arrangement. The order must direct that a certified copy of the same should be filed with the registrar of companies within 14 days from the date of the order or such other time as may be fixed by the court.

The court while sanctioning the scheme should consider (i) that the provisions of the Act have been complied with; (ii) those who took part in the proceedings at the meetings are representatives of the class to which the meeting belongs and that the majority of them acted bonafide; and (iii) having regard to the object, background and other conditions of the scheme, the scheme on the whole is reasonable.

The high court may also direct the official liquidator for submission of reports after scrutiny of the books and papers of the amalgamating company. If the report indicates that the affairs of the company have not been conducted in a manner prejudicial to the interest of the public and the shareholders, the court may issue orders for winding up with dissolution.

Application for Direction

If necessary, an application for direction of the court to provide for all or any matters indicated in Section 394(1). These are:

i. The transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company;
ii. The allotment or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which, under the

compromise or agreement, are to be allotted or appropriated by that company to or for any person;

iii. The continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;

iv. The dissolution, without winding-up, of any transferor company;

v. The provision to be made for any persons who, within such time and in such manner as the court directs, dissents from the compromise or arrangement; and

vi. Such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation would be fully and effectively carried out.

The court would pass an order. Alternatively, by adding a suitable prayer in the main application, the court could be requested to give direction in regard to the above. In fact, such a course would provide for expeditious completion of amalgamation formalities.

Certificate

A certified copy of the order of the court dissolving the amalgamating company or giving approval to the scheme of merger, should be filed with the Registrar of Companies concerned within 30 days of the date of the court's order.

Court Order

A copy of the order of the court should be to attached to the memorandum and articles of association of the transferee company [Section 39 391(4)]. As soon as the scheme of amalgamation has become effective, the members should be intimated through the press. Government authorities, banks, creditors, customers and others should also be informed.

Procedure for merger and acquisition laid down in the company's act 1956

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

■**Information to the stock exchange:** The acquiring and the acquired companies should inform the stock exchanges where they are listed about the merger.

■**Preparation and approval of the draft scheme by BOD of each company:** The BOD of the individual companies should approve the draft proposal for amalgamation and authorize the managements of companies to further pursue the proposal.

4. Application to the high court: An application for approving the draft amalgamation proposal duly approved by the BOD of the individual companies should be made to the high court.

5. 21 days notice for general meeting: To send notice for general meeting to every member along with a statement setting forth the terms of the compromise or arrangement and explaining its effect and particularly stating any material interests of the directors, managing director or manager.

6. Share holders and creditors meeting: The individual companies should hold separate meetings of their shareholders and creditors for approving the amalgamation scheme. At least 75% of shareholders and creditors in separate meeting, voting in person or by proxy, must accord their approval to the scheme.

The provisions of Company's Act 1956 related to merger and acquisition

- Sec. 376: condition prohibiting reconstruction or amalgamation of company
- Sec. 391:Power to compromise or make arrangements with creditors and members
- Sec. 392: Power of NLCT to enforce compromises and arrangements.
- Sec.393: deals with the information as to compromise or arrangement with creditors and members.
- Sec.394: deals with the provisions for facilitating reconstruction and amalgamation of companies.
- Sec.394A: relates to notice to be given to central government for application under sec. 391 and sec. 394.
- Sec.395: deals with the powers and duties to acquire shares of share holders dissenting from scheme or contract approved by majority.
- Sec.396: deals with the power of central govt. to provide for amalgamation of companies in national interest.
- Sec. 396A: relates to preservation of books and papers of amalgamated company.

PROVISIONS OF INCOME TAX ACT 1961

Sec 2 (1B) of the Income Tax Act 1961:- "amalgamation" in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company in such a manner that-

(i) All the property of the amalgamating company or companies immediately before the amalgamation, becomes the property of the amalgamated company by virtue of the amalgamation.

(ii) All the liabilities of the amalgamating company or companies immediately before the amalgamation, become the liabilities of the amalgamated company by virtue of the amalgamation.

(iii) Shareholders holding not less than three-fourth (in value) of the shares in the amalgamating company or companies become shareholders of the amalgamated company by virtue of the amalgamation.

Tax concessions to Amalgamated Company

■**Carry forward and set off of business losses and unabsorbed depreciation (sec.72A):** According to sec 72A, the amalgamated company is entitled to carry forward accumulated losses as well as unabsorbed depreciation of the amalgamating company, provided the following conditions are fulfilled:-

(i) Amalgamated company continuously holds, for a minimum of 5 years 3/4th of value of fixed assets of the amalgamating company acquired in the scheme of amalgamation.

(ii) Continues the business of the amalgamating company for a minimum of 5 years.

(iii) The amalgamated company fulfils such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purposes.

(iv) The amalgamation should be of a company owning an industrial undertaking or a ship or a hotel with another company or an amalgamation of a banking company.

2. Expenditure on scientific research: Where an amalgamating company transfers any asset represented by capital expenditure on scientific research to the amalgamated Indian company, in a scheme of amalgamation, unabsorbed capital expenditure in the books of the amalgamating company will be eligible to be carried forward and set off in the hands of the amalgamated company.

3. Expenditure on Acquisition of Patent Rights or Copy Rights:

The expenditure on patents and copyrights not yet written off in the books of amalgamating company shall be allowed to be written off by the amalgamated company in the same number of balance installments.

4. Expenditure on Know-how: Regarding the expenditure incurred on know-how, the amalgamated company shall be entitled to claim deduction with respect to the transferred undertaking, to the same extent and for the same residual period as otherwise would have been allowed to the amalgamating company, had such an amalgamation not taken place.

5. Expenditure for obtaining license to operate telecommunication services: When the amalgamating company transfers license to the Indian amalgamated company, in an amalgamation scheme, the expenditure on acquisition of license, not yet written off, is allowed to the amalgamated company in the same number of balance installments.

6. Preliminary expenses: Deduction of preliminary expenses will be made in the books of the amalgamated company in the same manner as would have been allowed to the amalgamating company.

7. Expenditure on prospecting, etc of certain minerals: The amount of expenditure on prospecting, etc. of certain minerals of the amalgamating company that are not yet written off, shall be allowed as deduction to the amalgamating company.

8. Capital expenditure on family planning: The capital expenditure on family planning not yet written off shall be allowed to the amalgamated company in the same number of balance installments.

9. Bad debts: When in the scheme of amalgamation, the debts of amalgamating company have been taken over by the amalgamated company and subsequently such debt will be allowed as a deduction to

the amalgamated company in the same manner as would have been allowed to the amalgamating company.

Tax concession to amalgamating company

- **Free of capital gains tax (sec.47(vi)):** transfer of any capital asset by an amalgamating company to the amalgamated company, in the scheme of amalgamation, will not be considered as a transfer for the purpose of capital gain, provided the amalgamated company is an Indian company.

- **Free of gift tax (sec.45 (b) of gift tax):** where there is a transfer of any asset by an amalgamating company in the scheme of amalgamation, gift tax will not be attracted, provided amalgamating company is an Indian company.

Tax concessions to the share holders of an amalgamating company

Sec.47 (vii):- Transfer of his shares by shareholder of an amalgamating company in the scheme of amalgamation, is disregarded for capital gain purposes provided the following conditions are satisfied:-

a. The transfer of shares is made in consideration of the allotment of any share to him or shares in the amalgamated company.

b. The amalgamated company is an Indian company.

SEBI Takeover Code

- As per recommendations of Justice P N Bhagwati committee and was incorporated in the SEBI Regulation Act, 1977.

It is a set of guidelines given by SEBI relating to regulations of mergers and takeovers. The salient features of the takeover code are as explained as under:

- Disclosure of holdings.
- Public announcement and open offer.
- Offer price.
- Disclosure.
- Content of the offer document.

1. SEBI Takeover Code – Disclosure of holdings

- If an acquirer holding 5%-14% wants to acquire share in a target company, he is bound to disclose such holding to target company or stock exchange within 2 days of acquisition.
- If he is holding 15%-75% wants to purchase/sell share aggregating to 2% or more, he is bound to disclose such holdings to target company within 2 days of such acquisition.
- If he is holding more than 15% shares and a promoter and person having control shall disclose his aggregate shareholding within 21 days before, 31st March to the target company.

2. Public announcement and open offer:

❖ Any acquirer intending to hold shares (other than promoters holding) which entitle 15% voting power can acquire such shares only after making public announcement to acquire at least 20% voting power from shareholders through an open offer.

❖ Acquirer holding more than 15% (other than promoters holding) but less than 75% of voting rights which entitles 5% voting rights in any financial year can do so only after making public announcement to acquire at least 20% shares of target company from shareholders through an open offer.

❖ Any acquirer holding more than 75% shares (other than promoters holding) can acquire further share only after public announcement to acquire at least 20% shares from shareholders through an open offer.

3. SEBI Takeover Code – Offer Price

- In determining the offer price it has to be ensured that all relevant parameters as listed below are taken into account:
    - Negotiated price under the agreement.
    - Price paid for acquisition
    - Average high and low prices of scripts of the acquiring company during the period needs to be disclosed to the target company.
    -

4. SEBI Takeover Code – Disclosure

- The offer document for such takeover has to disclose the following details in a clear manner
    - Detailed terms of the offer.
    - Identity of the offer.
    - Details of offerors existing holdings in Target Company.
    -

SEBI Takeover Code – Contents of the offer document

As per the law the offer document has to contain the following:

- Offer's financial info.
- Intention to continue offeree's business and to make major long term change and long term commercial justification of the offer.

- <u>**Salient features of SEBI takeover code**</u>

i. Notification of takeover:-

If an individual or company acquires 5% or more of the voting capital of a company, the target company and the stock exchange shall be notified immediately.

ii. Limit to share acquisition:-

An individual or a company can continue acquiring the shares of another company without making any offer to other shareholders until the individual or the company acquires 15% of the voting capital.

iii. Public offer:

If the holding of the acquiring company exceeds 15% , a public offer to purchase a minimum of 20% of the shares shall be made to the remaining shareholders through a public announcement.

iv. Offer price:

Once the offer is made to the remaining shareholders , the minimum offer price shall not be less than the average of the weekly high and low of the closing prices during the last 6 months preceding the date of announcement.

v. Disclosure:

The offer should disclose the detailed terms of the offer, identity of the offer details of the offerer's existing holdings in the offeree company etc., and the information should be made available to all the shareholder's at the same time and in the same manner.

vi. Offer document:

This offer document should contain the offerer's financial information, it's intensions to continue the offeree company's business and to make major change and long term commercial justification for the offer.