CORPORATE MERGERS IN INDIA

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ABSTRACT

The purpose of this paper is to study the postulation of Merger/Acquisition in detail by taking examples of some companies. The objective is to find out the major issues associated with pre and post merging situations with special emphasis on the human aspect. Merger/Acquisition is a phenomenon which is easy to think but hard to implement. Three phases of mergers – pre merger, transition phase and the post merger phase have its own advantages as well as difficulties, if handled with proper care synergies can be withdrawn but a little mistake can spoil the whole transition. Both management and employees have to work hard at their own level to make it a successful one because man is the major factor during the whole deal. Post merger transition phase is the most difficult one as in any organization whether large or small cultural clashes exist which may turn up a merger into the failure. When companies merge or make a plan for acquisition the only factor in their mind is growth or expansion or synergies. People factor is totally ignored. Either they are not involved anywhere or if involved then at very lower level.

INTRODUCTION TO MERGERS

"Growth through merger and acquisition has been a critical part of the success of many companies operating in the new economy. The plain fact is that acquiring is much faster than building. And speed-speed to market, speed to positioning and speed to becoming a viable company – is absolutely essential in the new economy."

-Alex Mandl[1]

Severe competition, extreme technological change, major corporate scandals and rising stock market volatility have increased the pressure on companies to deliver superior performance and value for its shareholders.

Even the corporate world today, is hit by Darwin's theory of evolution. i.e. survival of the fittest. A firm focusing on organic growth essentially focuses on achieving business growth through enhanced customer base as well as high sales, both physically and financially, together with growth in revenue. An inorganic growth opening, on the other hand, provides the organisation with an avenue for accelerated growth.[2] This being the reason why companies are focusing on inorganic growth through mergers these days.

In the modern 'winner takes all' economy, companies that fail to meet this challenge will face certain loss of their independence, if not extinction. Corporation restructuring has enabled thousands of organisations throughout the world to respond more quickly and effectively to new optiond and unanticipated pressures, thereby re-establishing their competitive advantage.[3] In the beginning of twenty first century, corporate restructuring by means of mergers have become a major force of new financial and economic environment across the globe.[4] To

[1] Alex Mandal, Chairman and Chief Executive of Teligent, Commented this in 2000 Edition of Harvard Business Review, as quoted in Rachna Jawa, *Mergers, Acquisitions and Corporate Restructuring in India*: *Procedure and Case Studies*, New Century Publications, New Delhi, 2009, p. 29.
[2] Vikamaditya Singh Malik and Vikrant Pachnanda, "Growth via Mergers v. Organic Growth: The Indian Context", *Company Law Journal*, 2009, Vol. 4, pp. 24-36, p. 24.
[3] Kawalpreet Kaur, "Impact of Takeovers: A Step Ahead or Behind", *A Project Report*, Department of Commerce Business and Management, Guru Nanak Dev University, (Unpublished), 2005, p. 1.
[4] D.N.S. Kumar, "Strategic Acquisition through Value Based Management: A Case Analysis", *Abhigyan*, Vol. XXIV, No. 4, Jan-March 2007, pp. 42-47. p. 42.

survive in an increasingly competitive global economy, it is essential to enhance size by joining hands with those.[5]

THEORIES OF MERGERS

Merger is said to occur when two or more companies combine into one company. In a merger, one or more companies can merge with an existing company (merger through absorption) or they can merge to form a new company (merger through consolidation or amalgamation).[6] Generally, mergers mean any transactions that forms one economic unit from two or more pervious ones.[7] According to Weinberg and Blank:

> "A 'merger' may be defined as an arrangement whereby the assets of two companies become vested in, or under the control of, one company (which may or may not be one of the original two companies) which has as its shareholders or substantially all, the shareholders of the two companies. A merger is effected by the shareholders of one or both of the merging companies exchanging their shares (either voluntarily or as a result of legal operation) for shares in the other or a third company."[8]

It is the fusion between two or more enterprises, whereby the identity of one or more is lost and they result in a single enterprise. Example, both Centurion Bank and Bank of Punjab ceased to exist when the two banks merged, a new banking company Centurion Bank of Punjab was formed.

It can also happen the other way around, when one loses its identity and is merged into another, for example in 2010, the Bank of Rajasthan merged with ICICI Bank, the India's largest private sector bank in an all share deal at about Rs 30.41 billion.[9]The Bank of Rajasthan lost its identity and merged into ICICI Bank. The same happened in Feb 2008 when Centurion Bank of Punjab

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[5] Rachna Jawa, *Mergers, Acquisitions and Corporate Restructuring in India*: *Procedure and Case Studies*, New Century Publications, New Delhi, 2009, p. 1.
[6] I.M. Pandey, *Financial Management*, Vikas Publishing House (P.) Ltd., New Delhi, 2007, p. 672.
[7] J. Fred Weston et al., 1990, p. 4.
[8] M.A. Weinberg et al., *Weinberg and Blank on Take-overs and Mergers*, Sweet and Maxwell, London, 1979, p. 4, para 104.
[9] Ernst and Young, 2011, p. 7.

was merged into HDFC Bank for $2.4 billion. In any merger, the shareholders of the company or companies, whose identities have been merged will be allotted shares in the merged company in exchange for the shares held by them in the merging company or companies, according to the share exchange ratio engulfed in the scheme of merger as approved by all or the prescribed majority of shareholders of the merging companies and the merged company in their separate general meetings .For example, in March 2009 when RPL (Reliance Petroleum Limited) merged into RIL (Reliance Industries Limited), the swap ratio was fixed a 16:1 i.e. for every 16 shares in RPL, the shareholders get 1 share in RIL whereas in 2002-03, when IPCL (Indian Petrochemicals Limited) got merged into RIL, the shareholders got 1 share of RIL for every 5 shares held by them. In 2012, in the merger of Sesa Goa-Sterlite industries, Sterlite shareholders got 3 shares in Sesa Goa for every 5 shares held in Sterlite industries.

Theories of M&A:

Many theories have been advanced to explain why it takes place. Efficiency theories imply social gains from Mergers activity in addition to the gains for parties.

1. ***Differential efficiency Theory***: Higher efficient firms will acquire lower efficient firms and realize gains by improving their efficiency. It would be most likely to be a factor in mergers between firms related industries where the need for improvement could be more easily identified.
2. ***Inefficient Management Theory***: The target companies management is so inefficient that virtually any management could do better, and hence could be an explanation for mergers between firms in unrelated industries. This theory's main limitation is its implication, agency costs are so high that shareholders have no way to discipline managers, sort of costly merger.
3. ***Operating Synergy Theory:*** Economies of scale or of scope and those mergers help achieve levels of activities at which they can be obtained. It includes the notion of complementary of capabilities. For example, one firm might be strong in R&D but weak in marketing while another has a strong marketing department without the R&D capability. Merging the two firms would result in operating synergy.
4. ***Financial Synergy Theory***: Hypothesis complements between merging firms, not in terms of management capabilities, but in the terms of availability of investment possibility im internal cash flow. Most of firms in a declining industry will produce

large cash flows since there are very few attractive investment possibilities whereas a growth industry has more investment opportunities than cash. The merged firm will have a lower cost of capital because of the lower cost of internal funds as well as possible risk reduction including savings in flotation costs, and improvements in capital allocation.

5. ***Pure diversification Theory***: Pure diversification as a theory of mergers differs from shareholder portfolio diversification. Shareholders may efficiently spread their investment and risk amongst industries, so there does not exist any need for firms to diversify for the sake of their shareholders. Managers and other employees, however, are at greater risk if the only industry in which their firm operates should fail their firm specific human capital is not transferable. Therefore, firms /may not diversify to encourage firm specific human capital investments which makes their employees more valuable and productive, and to increase the probability that the organization and reputation capital of the firm will be preserved by transfer to another line of business owned by the firm in the event its initial industry declines.
6. ***Theory of Strategic Alignment to changing environment***: External acquisitions of needed capabilities by a firm, allow such firms to adapt more quickly and with less risk than developing capabilities internally.
7. ***Undervaluation Theory:*** Mergers occur when the market value of target firm stock for some reason does not reflect it true of potential value. Firms acquire assets for expansion more cheaply by buying the stock of existing firms than by buying or building the assets when the target's stock price is below the replacement cost of its assets.
8. ***Signaling Theory***: Theories other than efficiency theory, include information and signaling agency problems and managerialism, free cash flow, market power, taxes, and redistribution concept. The information or signaling theory attempts and explains why target shares seem to be permanently revalued upward in a tender offer irrespective of it being successful or unsuccessful. The 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 management, which inspires them to implement a more efficient strategy on their own. Another school holds that the revaluation is not really permanent, but only reflects the likelihood that another acquirer will materialize for a

synergistic combination. Other aspects of takeovers may also be interpreted as signals value, including the means of payment and target management's response to the offer.

9. ***Agency Theory***: Agency problems may result from a dissent of interest between managers and shareholders or between shareholders and debt holders. A number of organization and market mechanisms serve to discipline self serving managers, and takeovers are viewed as the discipline of last resort. On the other hand managerialism, views, takeovers as demonstration of the agency problem rather than its solution. It suggests that self-serving managers make ill-conceived combinations solely to increase firm size and their own compensation.
10. ***Hubris Theory***: The hubris theory is another variant on the agency's cost theory; it implies that an acquiring firm managers commit errors of over optimism (winner's curse) in bidding for targets.
11. ***H.Jensen's Free Cash Flow Theory***: Generally takeovers take place because of the existing conflicts between managers and shareholders over the payout of free cash flows. The hypothesis points that free cash flows (that is, in excess of investment needs) should be paid out to shareholders, reducing the power of management and subjecting managers to the scrutiny of the public capital markets in less intervals. Debts for stock exchange offers are viewed as a means of bonding the mangers. Promise to pay out future cash flows to shareholders.
12. ***Market Power Theory***: Market power advocates claim that merger gains are the result of rapid increasing concentration leading to collusion and monopoly effects. Empirical evidence on whether industry concentration causes reduced competition is not conclusive. There is much evidence that concentration is the result of vigorous and continuing competition which causes the composition of the leading firms to change over time.
13. ***Tax Effects Theory***: Tax effects theory do not play a major role in explaining M&A activity overall. Carryover of net operating losses and tax credits, stepped up asset basis, and the substation of capital gains for ordinary income (less important after the Tax Reform Act of 1986) are among the tax motivations for mergers. Emerging inheritance taxe,s may also motivate the sale of privately held firms with aging owners. 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 hypotheses may include bondholders, the government (in the case of tax savings), and organized labour.

LEGAL & REGULATORY FRAMEWORK FOR MERGERS

The term ‘merger’ is not defined under the Companies Act, 1956, and under Income Tax Act, 1961. However, the Companies Act, 2013 without strictly defining the term explains the idea. A ‘merger’ is a combination of two or more entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities but also organization of such entity into one business.

Chapter XV of the 2013 Act, Sections 230 to 240 deals with “Compromises, Arrangements and Amalgamations.” Merger results in merger of all the assets, liabilities of the entities under one business. The dissolution of company/companies involved in a merger takes place without winding up. The possible benefits of mergers can be various- economies of scale, acquisition of technologies, access to sectors / markets etc.

- **Procedure:** The memorandum of association of the companies willing to merge, should give power to companies to amalgamate. Such merger scheme must be approved prior by the creditors of the company. Notice of merger along with merger proposal and valuation report etc. Are needed to be served to the creditors, shareholders, and various regulators (MCA, RBI, CCI, Stock exchanges of listed companies, IT authorities and sectoral authority likely to be affected by merger.) Shareholders and creditor both are given option to cast their vote through postal ballot. Tribunal has the power to order meeting of creditors if application is made to the Tribunal under section 230[10] for purpose of sanctioning of a compromise or an arrangement for merger or amalgamation. Objections only be raised by shareholders who hold 10% or more equity or creditors whose outstanding debt is 5 % or more of the total debt as per last audited balance sheet only[11]. Prior certifications from auditors saying accounting treatment is in consonance with accounting standards needs to be filed with stock exchanges (for both listed and unlisted companies).[12]

[10] Sec.230(*1*) and Sec.230(*9*), Companies Act 2013
[11] Sec.230(*4*), Companies Act 2013
[12] Sec.230(*5*), Companies Act 2013

Board of Directors are to approve the draft proposal after which application is to be made to respective High Court (State where registered office is located) in Form no. 36. After the aforementioned approval, the scheme has to be filed with the Official Liquidator, RoC and the Central Government. Also, the draft is sent with the notice to the class of members. In the event of there being "no objection," it will be deemed as approved.[13] The 2013 Act has established National Company Law for the purpose of deciding all the matters related to company law and replace the HCs[14].

After the Court order, its certified copies are to be filed with the Registrar of Companies.[15] The assets and liabilities of the acquired company will remain transferred to the acquiring company in accordance with the approved scheme, with effect from the specified date. As per the proposal. The acquiring company will exchange shares and debentures and/or cash for the shares and debentures of the acquired company. These securities will be listed on the stock exchange.

- **Fast track mergers: The Act provides for Fast track mergers[16] in cases of merger between:**
    1. two or more small companies or
    2. between a holding company and its wholly-owned subsidiary company or
    3. such other class or classes of companies as may be prescribed;

Under this, the notice of the proposal to the Registrar, official regulators and persons affected by the merger has to be sent within thirty days. They can provide their objections and suggestions. The merger proposal has to be approved by member holders of 90% shares at the general meeting and majority representing nine-tenths in value of the creditors at the meeting convened by giving 21 days notice. The notice to the meeting to members and creditors has to be accompanied by merger scheme and declaration of solvency. Minority shareholders are provided with an exit mechanism.

[13] Sec. 230(*6*), Companies Act 2013
[14] Sec. 230(*7*), Companies Act 2013
[15] Sec.230(*8*), Companies Act 2013
[16] Sec. 233, Companies Act 2013

Within 7 days of the meeting the transferee company has to file merger scheme and declaration of solvency with ROC. Objections of ROC or official liquidator have to be communicated to Central Government within 30 days in writing. Central government has time period of 60 days after receiving merger proposal to file objections before tribunal which will consider whether the scheme is appropriate for fast track merger or not.

- **Cross border mergers**: This Act also permits 'Cross border mergers' between Indian and foreign company located in a jurisdiction notified by Central government in consultation with RBI.[17] The consideration of a merger of this type will be subject to the approval of the RBI, could either be in cash or depository receipts, or partly in cash and partly in depository receipts

RECENT SCENARIO OF MERGERS IN INDIA

Financial Restructuring through merger is taking place with an unprecedented/unpredictable pace all over the world including India during the last few years.[18]Dramatically, over the past few years the news paper headlines were found to be full with such news[19] Ex: the Jet-Sahara merger

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

Repute and image of corporate India has undergone a rapid change in the past few decades. Surely the founding fathers of the TATA Group would not have dreamt about acquiring Ford, Jaguar Land Rover or cracking the deal with Corus. With the cross-border merger and acquisitions activity in India growing at a rampant rate, a stage has been set for several smaller

[17] Section 234, Companies Act, 2013
[18] Bhasin, "Mergers and Acquisition: An Overview", *Manupatra Newsline*, Vol. 1, Issues 7, December 2006, pp. 11-13, p. 11.
[19] *Ibid*.

business enterprises to take a dive into the market and this seems quite beneficial for the Indian economy.

Notable Merger deals:

1. Merger of Bank of Rajasthan with India's largest private sector bank in an all share deal valued at about Rs. 30.41 billion in May 2010 which gave ICICI Bank sustainable competitive advantage over its customers in Indian banking.[20]
2. RNLR born out of demerger of Dhirubai Ambani's Reliance in 2005 merged with Reliance Power in a mega Rs. 50,000 crore deal in July 2010. The combined entity had over 60 lakh shareholders-the largest for any entity in the world.[21]
3. In a biggest ever merger in the Indian Pharmaceutical Industry, Sun Pharmaceuticals acquired Ranbaxy from its Japanese parent Daiichi Sankyo in a deal valued at $4 billion.
4. Tata Fertilisers Ltd. (TFL) by Tata Chemicals Ltd. (TCL). TCL, an acquiring company (a buyer), survived after merger while TFL, an acquired company (a seller), ceased to exist.
5. Hindustan Computers Ltd, Hindustan Instrument Ltd, Indian Software Company Ltd and Indian Reprographics Ltd. in 1986 to an entirely new company called HCL Ltd.[22]
6. Trends emerging now clearly shows the strategic shift in the behavioural pattern of Indian entrepreneurs, who are now more willing to sell a part or whole of their stake to exit their business to foreign players.[23] i.e. focus of deal activity shifting from outbound to inbound. The reason for all such trend reversal is the weak Indian rupee which has made Indian businesses on international market. Attractive valuations from foreign entities, given significant growth openings in India are prompting Indian entrepreneurs to evaluate exits. Moreover, there is significant shift in attitude and behaviour of Indian entrepreneurs who focus with open mind to evaluate strategic buyers, and to exit their age-old businesses and this trend is expected to continue. Few successful exits in the recent past by the Indian promoters include Daiichi-Ranbaxy and Abott-Piramal.

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[20] For further details, see, K.A. Goyal and Vijay Joshi, "Merger and Acquisition in Banking Industry: A Case Study of ICICI Bank Ltd", *International Journal of Research in Management*, March 2012, Vol. 2, Issue 2, pp. 30-39

[21] Nod for RNRL, R-Power Merger", *The Tribune*, 5 July 2010, p.19.

[22] *Ibid*.

[23] Raja Lahiri, "An Overview: M&A in India", Grant Thornton (ed.), "New Dimensions in M&A Regulatory Framework", *http://www.granthornton.in/assets/GrantThorntonIndiaLLP-Assocham-M&A.pdf*, accessed on 13 August 2018 at 4.00 pm.

CONCLUSION AND SUGGESTIONS

"Mastering the art of deal making is what transforms an everyday company into a leading business empire."[24]

In my views, merger waves will continue in India in the upcoming years and India's Mergers environment would continue to grow stronger and bigger in years to come. As Western economies continue to show signs of weaknesses, Indian corporate sector should aim at seizing this time and opportunity to strengthen India's market position, while expanding its global footprint.

Reasons for failure of various mergers are due to non-integration of human resources of both the companies. One of the most prominent failures due to lack of human resource integration is the merger of Air India-Indian Airlines. In this case,major attention was given to discussion around non-core issues such as long-term fleet acquisition, establishing subsidiaries for ground handling and maintenance then on human resources-one of the most precious asset of any organisation which lead to a potentially messy situation for the merged enterprise. In case of many mergers, dissatisfied are even approaching to the door of our courts and court has done the needful in many cases to protect their rights.

Suggestions:

1. ***Removal of Thresholds for Making Objection:*** The act provides that persons holding minimum 10 percent of shares or 5 percent of total outstanding debt can raise objections to the scheme. But the interest of small shareholders and creditors are undermined as it substantially erodes their power of objections. The minority would need to commit substantial effort in pooling stakes if they want to raise objections, unless a large institutional shareholders agrees to take their cause.
2. ***Approval of the Scheme:*** The Act require that scheme for merger or any arrangement should be approved by a majority in number also representing 3/4th in value of shareholders/creditors present and voting. The requirement of majority in number does

[24] Quoted from *http://www.businessinsider.com/greatest-ma-quotes-of-all-times-2013-5?1R=T*, accessed on 14 April 2018 at 12.51 am.

not serve any useful purpose considering that value is simultaneously being considered as a criteria and poses an additional hurdle to approval of the scheme. Moreover, international best practices recognise value as the determining. So section 230(6) should be modified to provide only for approval by 3/4th in value of shareholders and creditors, present and voting.

To sum up, inspite of overwhelming importance of the human resources in Mergers, they are often ignored as more stress is laid on the financial aspects of the transaction. But they should be addressed simultaneously along with issues of financial and legal integration if not well before. The success of a merger and acquisition depends on how well an organisation deals with issues related to its people and cultural integration. If success has to be achieved in the market place, what is required is a cohesive, well integrated and motivated workforce willing to take on the multifarious challenges that arise on the horizon from time to time.