A STUDY ON MERGERS AND ACQUISITION IN INDIA

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ABSTRACT

Mergers and acquisitions is a general term that describes the consolidation of companies or assets through various types of financial transactions, including mergers, acquisitions, consolidations, tender offers, purchase of assets, and management acquisitions. The term Mergers and Acquisitions also refers to the desks at financial institutions that deal in such activity. The terms "mergers" and "acquisitions" are often used interchangeably, but they differ in meaning. In an acquisition, one company purchases another outright. A merger is the combination of two firms, which subsequently form a new legal entity under the banner of one corporate name. A company can be objectively valued by studying comparable companies in an industry and using metrics.

Keywords*: Mergers, Acquisition, Operating, Performance*

INTRODUCTION

The terms mergers and acquisitions are often used interchangeably, however, they have slightly different meanings. When one company takes over another and establishes itself as the new owner, the purchase is called an acquisition.

On the other hand, a merger describes two firms, of approximately the same size, that join forces to move forward as a single new entity, rather than remain separately owned and operated. This action is known as a merger of equals. Case in point: Both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created. Both companies' stocks were surrendered, and new company stock was issued in its place.

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. Unfriendly or hostile takeover deals, in which target companies do not wish to be purchased, are always regarded as acquisitions. A deal can be classified as a merger or an acquisition based on whether the acquisition is friendly or hostile and how it is announced. In other words, the difference lies in how the deal is communicated to the target company's board of directors, employees, and shareholders.

THE IDEA BEHIND COMPANIES SCALING UP

The general idea underlying Merges & Acquisition is that when two distinct organizations work together, they create greater value than if they worked alone. Companies continue to evaluate different options through mergers and acquisitions with the primary goal of maximizing wealth. The combining or merging of two companies always creates synergy benefits in this case. Revenues (greater revenues), Expenses (lower expenses), or the cost of capital can all be used to determine the synergy value (lowering of the overall cost of capital)[i]

Both sides of Merges & Acquisition negotiation will have varying viewpoints about the valuation of an acquiring company: the seller wants to value the company as high as possible,

while the buyer wants to secure the best deal possible. There are, however, a plethora of valid methods for determining a company's worth.

The most frequent way for valuing a company is to compare it to similar companies in the same industry, but dealmakers use a range of other approaches and tools when evaluating a target company.

The following are a few of them:

Comparative Ratios: The following are two examples of the many comparative metrics on which acquiring companies may base their offers:

1. **Price-Earnings Ratio (P/E Ratio):** With this ratio, an acquiring company makes an offer that is a multiple of the earnings of the target company. Looking at the P/E for all the stocks within the same industry group will give the acquiring company good guidance for what the target's P/E multiple should be.
2. **Enterprise-Value-to-Sales Ratio (EV/Sales):** With this ratio, the acquiring company makes an offer as a multiple of the revenues, again, while being aware of the price-to-sales ratio of other companies in the industry.

Replacement Cost: In a very few cases, acquisitions are based on the cost of replacing the target company. For simplicity's sake, suppose the value of a company is simply the sum of all its equipment and staffing costs. The acquiring company can literally order the target to sell at that price, or it will create a competitor for the same cost. Naturally, it takes a long time to assemble good management, acquire property and get the right equipment.

Discounted Cash Flow (DCF): This is a key valuation tool in M & A. Discounted cash flow analysis determines a company's current value according to its estimated future cash flows. Forecasted free cash flows (net income + depreciation/amortization − capital expenditures − change in working capital) are discounted to a present value using the company's weighted average costs of capital (WACC).

DEFINITIONS

Mergers, acquisitions and takeovers have been a part of the business world for centuries. In today's dynamic economic environment, companies are often faced with decisions concerning these actions - after all, the job of management is to maximize shareholder value. Through mergers and acquisitions, a company can (at least in theory) develop a competitive advantage and ultimately increase shareholder value. The said terms to a layman may seem alike but in legal/ corporate terminology, they can be distinguished from each other:

1. Merger: A full joining together of two previously separate corporations. A true merger in the legal sense occurs when both businesses dissolve and fold their assets and liabilities into a newly created third entity. This entails the creation of a new corporation.
2. Acquisition: Taking possession of another business. Also it called as a takeover or buyout. It may be share purchase (the buyer buys the shares of the target company from the shareholders of the target company. The buyer will take on the company with all its assets and liabilities.) or asset purchase (buyer buys the assets of the target company from the target company)

In simple terms, A merger involves the mutual decision of two companies to combine and become one entity; it can be seen as a decision made by two "equals", whereas an acquisition or takeover on the other hand, is characterized the purchase of a smaller company by a much larger one. This combination of "unequals" can produce the same benefits as a merger, but it does not necessarily have to be a mutual decision[ii]. A typical merger, in other words, involves two relatively equal companies, which combine to become one legal entity with the goal of producing a company that is worth more than the sum of its parts. In a merger of two corporations, the shareholders usually have their shares in the old company exchanged for an equal number of shares in the merged entity. In an acquisition, the acquiring firm usually offers a cash price per share to the target firm's shareholders or the acquiring firm's share's to the shareholders of the target firm according to a specified conversion ratio. Either way, the purchasing company essentially finances the purchase of the target company, buying it outright for its shareholders

3. Joint Venture: Two or more businesses joining together under a contractual agreement to conduct a specific business enterprise with both parties sharing profits and losses. The venture is for one specific project only, rather than for a continuing business relationship as in a strategic alliance.

4. Strategic Alliance: 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 your leverage.

5. Partnership: A business in which two or more individuals who carry on a continuing business for profit as co-owners. Legally, a partnership is regarded as a group of individuals rather than as a single entity, although each of the partners file their share of the profits on their individual tax returns.

Many mergers are in truth acquisitions. One business actually buys another and incorporates it into its own business model. Because of this misuse of the term merger, many statistics on mergers are presented for the combined mergers and acquisitions that are occurring. This gives a broader and more accurate view of the merger market.

THE PREMIUM FOR POTENTIAL SUCCESS

Almost often, acquiring businesses pays a significant premium above the stock market value of the business they buy. The argument for doing so almost usually boils down to the concept of combination: a merger rewards shareholders when the value of prospective synergy enhances a company's post-merger stock price. If rational owners would profit more from not purchasing, they would be exceedingly unlikely to sell. It means that, irrespective of what the pre-merger valuation says, bidders will have to pay extra if they want to buy the company.

Companies engage in mergers and acquisitions for a variety of strategic business reasons, the majority of which are economic in origin. These include leveraging economy of scale in any,

some, or all areas of research and innovation, production, and marketing (horizontal mergers); expanding distribution network or entering new markets to increase market share; diversifying the variety of products and services (diversification of business); gaining professional leadership by being purchased (by a smaller company); and diversifying the array of goods and services (diversification of business).

Other incentives can be considered, such as gaining distribution network pricing efficiency through the acquisition of a distribution channel (vertical merger) or even eliminating future competition. The activity of mergers and acquisitions has resulted in the internationalization of company activities. Mergers and acquisitions have become more popular as a quick and successful convergence technique, particularly in the cross-border scene. These are mostly driven by the volatile global economic environment, with emerging-market corporations scrambling to acquire cross-border assets at attractive rates, particularly following the 2008 Global Financial Crisis[iii]

Many Indian businesses are exploring international partners, particularly in the West, to expand their market share and improve efficiencies. This transition is most noticeable in information technology, metals, pharmaceuticals, and life sciences, as well as the automobile and ancillary industries. The primary reason for mergers and acquisitions is to maximize shareholder value, which is achieved by increasing the firm's market value as a result of the merger. This can be accomplished through boosting profits, which can be accomplished through cost efficiency of scale, economies of scope, and economies of vertical integration, as well as synergies through cost savings research and development, rationalization, purchasing power, the creation of internal capital markets, and financial savings-tax and interest rates.

Mergers and acquisitions have recently proven to be a panacea for highly leveraged corporations. This phenomenon became more apparent after 2015 when the banking sector tightened its lending standards. Unlike in the past, when most Merges and Acquisition agreements were driven by growth, overleveraged corporations tried to decrease debt by selling assets.

Types of Mergers:

Based on the objectives profile, combinations could be vertical, horizontal, circular and conglomeratic as precisely described below with reference to the purpose in view of the offer or company.

(A) Vertical combination:

A company would like to take over another company or seek its merger with that company to expand espousing backward integration to assimilate the resources of supply and forward integration towards market outlets. The acquiring company through merger of another unit attempts on reduction of inventories of raw material and finished goods, implements its production plans as per the objectives and economizes on working capital investments.

In other words, in vertical combinations, the merging undertaking would be either a supplier or a buyer using its product as intermediary material for final production.

The following main benefits accrue from the vertical combination to the acquirer company:

(1) It gains a strong position because of imperfect market of the intermediary products, scarcity of resources and purchased products;

(2) Has control over products specifications.

(B) Horizontal combination:

It is a merger of two competing firms which are at the same stage of industrial process. The acquiring firm belongs to the same industry as the target company. The mail purpose of such mergers is to obtain economies of scale in production by eliminating duplication of facilities and the operations and broadening the product line, reduction in investment in working capital, elimination in competition concentration in product, reduction in advertising costs, increase in market segments and exercise better control on market.

(C) Circular combination:

Companies producing distinct products seek amalgamation to share common distribution and research facilities to obtain economies by elimination of cost on duplication and promoting market enlargement. The acquiring company obtains benefits in the form of economies of resource sharing and diversification.

(D) Conglomerate combination:

It is amalgamation of two companies engaged in unrelated industries like DCM and Modi Industries. The basic purpose of such amalgamations remains utilization of financial resources and enlarges debt capacity through re-organizing their financial structure so as to service the shareholders by increased leveraging and EPS, lowering average cost of capital and thereby raising present worth of the outstanding shares. Merger enhances the overall stability of the acquirer company and creates balance in the company's total portfolio of diverse products and production processes.

REASONS FOR MERGERS AND ACQUISITIONS

One of the most reasons for mergers and acquisitions is the belief that "synergies" exist, allowing the two companies to work more efficiently together than either would separately. Such synergies may result from the firms' combined ability to exploit economies of scale, eliminate duplicated functions, share managerial expertise, and raise larger amounts of capital. Merger is a tool used by companies for the purpose of expanding their operations often aiming at an increase of their long term profitability. Usually mergers occur in a consensual (occurring by mutual consent) setting. The dictionary meaning of Mergers is "to combine commercial or industrial firms" or "to lose identity by being absorbed in something else.

The basic purpose of merger or business combination is to achieve faster growth of the corporate business. Faster growth may be had through product improvement and competitive position.

1) **Procurement of supplies:** To safeguard the source of supplies of raw materials or intermediary product

2) **Revamping production facilities:** To achieve economies of scale by amalgamating production facilities through more intensive utilization of plant and resources;

3) **Market expansion and strategy:** To eliminate competition and protect existing market;

4) **Financial strength:** To improve liquidity and have direct access to cash resource;

5) **Strategic purpose:** The Acquirer Company view the merger to achieve strategic objectives through alternative type of combinations which may be horizontal, vertical, product expansion, market extensional or other specified unrelated objectives depending upon the corporate strategies

6) **Desired level of integration:** Mergers and acquisition are pursued to obtain the desired level of integration between the two combining business houses. Such integration could be operational or financial.

ADVANTAGES OF MERGERS AND TAKEOVERS

Mergers and acquisitions are caused with the support of shareholders, managers and promoters of the combining companies.

From the standpoint of shareholders:

Investment made by shareholders in the companies subject to merger should enhance in value. The sale of shares from one company's shareholders to another and holding investment in shares should give rise to greater values i.e. the opportunity gains in alternative investments. Shareholders may gain from merger in different ways viz. from the gains and achievements of the company i.e. through

(a) realization of monopoly profits;

(b) economies of scales;

(c) diversification of product line;

(d) acquisition of human assets and other resources not available otherwise;

(e) Better investment opportunity in combinations.

From the standpoint of managers:

Managers are concerned with improving operations of the company, managing the affairs of the company effectively for all round gains and growth of the company which will provide them better deals in raising their status, perks and fringe benefits. Mergers where all these things are the guaranteed outcome get support from the managers. At the same time, where managers have fear of displacement at the hands of new management in amalgamated company and also resultant depreciation from the merger then support from them becomes difficult.

Promoter's gains:

Mergers do offer to company promoters the advantage of increasing the size of their company and the financial structure and strength. They can convert a closely held and private limited company into a public company without contributing much wealth and without losing control.

Benefits to general public:

Impact of mergers on general public could be viewed as aspect of benefits and costs to:

(a) Consumer of the product or services;

(b) Workers of the companies under combination;

(c) General public affected in general having not been user or consumer or the worker in the companies under merger plan.

Mergers are pursued under the Companies Act, 1956 vide sections 391/394 thereof or may be envisaged under the provisions of Income-tax Act, 1961 or arranged through BIFR under the Sick Industrial Companies Act, 1985

EFFECTS OF MERGERS AND ACQUISITIONS

Effects 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 knew fact that whenever there is a merger or an acquisition and there are bound to be lay off. 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 labour 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[iv]. 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.

Effect on Management:

Effect of mergers and acquisitions on top level management:

It 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.

Effects of Mergers and Acquisitions on Shareholders:

We can further categorize the shareholders into two parts:

1. The Shareholders of the acquiring firm
2. The shareholders of the target firm.

1. 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 then 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.

2. 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[v]

CONCLUSION

Mergers and acquisitions have gained importance in recent times. Business consolidation by large industrial houses, consolidation of business by multinationals operating in India, increasing competition amongst domestic companies and competition against imports have all combined to spur mergers and acquisitions activities in India.

2006 will be remembered in India's corporate history as a year when Indian companies covered a lot of new ground. They went shopping across the globe and acquired a number of strategically significant companies. This comprised 60 per cent of the total mergers and acquisitions activity in India in 2006. And almost 99 per cent of acquisitions were made with cash payments.

Just as mergers and acquisitions may be fruitful in some cases, the impact of mergers and acquisitions on various sects of the company may differ. Mergers and acquisitions are aimed at improving profits and productivity of a company. Simultaneously, the objective is also to reduce expenses of the firm. However, mergers and acquisitions are not always successful. At

times, the main goal for which the process has taken place loses focus. The success of mergers, acquisitions or takeovers is determined by a number of factors. Those mergers and acquisitions, which are resisted not only affects the entire work force in that organization but also harm the credibility of the company. In the process, in addition to deviating from the actual aim, psychological impacts are also many. Studies have suggested that mergers and acquisitions affect the senior executives, labour force and the shareholders.

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