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MERGERS & ACQUISITIONS: DUE LEGAL PROCEDURE

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ABSTRACT:
The most talked about subject of the day is Mergers & Acquisitions (M&A). In developed economies, corporate Mergers and Acquisition are a regular feature. In Japan, the US and Europe, hundreds of mergers and acquisition take place every year. In India, too, mergers and acquisition have become a corporate game today.In Asia, India stands next only to China in M & A activity. There were 163 inbound acquisitions in India valued at $2.83 billion. There will be more mergers and acquisition in the near future consequent upon the streamlining of the legal framework

1. MEANING AND NATURE OF MERGER & ACQUISITION (M & A):

The terms ‘mergers’, ‘acquisitions’ and ‘takeovers’ are often used interchangeably in common parlance. However, there are differences. While merger means unification of two entities into one, acquisition involves one entity buying out another and absorbing the same. In India, in legal sense merger is known as ‘Amalgamation’. The amalgamations can be by merger of companies within the provisions of the Companies Act, and acquisition through takeovers. While takeovers are regulated by SEBI. M & A deals fall under the Companies Act. In cross border transactions, international tax considerations also arise.

The defined amalgamation as a blending of two or more existing undertakings, the shareholders of each **amalgamating** company becoming substantially the shareholders in the **amalgamating** company. Accordingly, in a merger, two or more companies combine into a single unit. The term “amalgamation” is used when two or more companies are amalgamated or where one is merged with another or taken over by another. In Inland steam Navigation Workers Union vs. R.S. Navigation Company Ltd. It was observed that in case of amalgamation, the rights and liabilities of a company are amalgamated into another so that the transferee company becomes vested with all rights and liabilities of the transferor company.

An **acquisition** is when both the acquiring and acquired companies are still left standing as separate entities at the end of the transaction. A **merger** results in the legal dissolution of one of the companies, and a **consolidation** dissolves both of the parties and creates a new one, into which the previous entities are merged.

Corporate takeovers were started by Swaraj Paul when he tried to takeover Escorts. The other major takeovers are that of Ashok Leyland by the Hindujas Shaw Wallace, Dunlop, and Falcon Tyres by the Chabbria Group; Ceat Tyres by the Goenkas; and Consolidated Coffee by Tata Tea. The BIFR arranged for the takeover of companies by giants like ITC, McDowells, Lakshmi Machine Works, and the Somani Group.

Many new companies are being incorporated as a result of the fast growing industrialization of the country which is mainly dependent on agriculture. With the new trends of globalization, not only in this country but also worldwide, there has been increasing interaction of companies and persons of one country with those of other countries.

Today, corporate restructuring has gained momentum and undertakings and companies are merging, demerging, divesting and taking in or taking over companies and undertakings, both unregistered and registered, in India and outside.

Against this corporate backdrop, mergers and acquisitions have to be encouraged in the interest of the general public and for the promotion of industry and trade. At the same time the government has to safeguard the interest of the people, the consumers and the investors on the one hand and the shareholders, creditors and employees/workers on the other.

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In fact, mergers and acquisitions may take place as a result of “reconstruction” “compromise” or “arrangement” as envisaged by Sections 230 to 240 of the Companies Act, 2013 and “reconstruction” of a sick industrial company as envisaged Sick Industries (Special Provisions) Act, 1985 or “revival” of financially unviable companies as envisaged by Income Tax Act, 1961.

However, all such mergers and acquisition have to be governed or controlled by the relevant provisions of the Foreign Exchange Management Act, 2000 Income Tax Act, 1961; Industries (Development and Regulation) Act, 1973; the restrictions imposed by other relevant Acts including SEBI Act, 1992 as the case may be.

According to Accounting Standard (AS) -14, "Accounting for Amalgamation", it means an amalgamation pursuant to the provisions of the Companies Act, 1956 or any other statute which may be applicable to companies.

Amalgamationsignifies the transfer of all or some part of the assets and liabilities of one or more than one existing company to another existing company or of two or more existing companies to a new company of which transferee company or all the members of the transferor company or companies become, or have the right of becoming, members and generally, such amalgamation is accomplished by a voluntary winding-up of the transferor company or companies.

Under an amalgamation, merger or takeover, two (or more) companies are merged either dejure by a consolidation of their undertakings or defacto by the acquisition of a controlling interest in the share capital of one by the other or of the capital of both by a new company.

Amalgamation is a state of things under which either two companies are so joined to form a third entity or one is absorbed into or blended with another." "Generally, where only one company is involved in a scheme and the rights of the shareholders and creditors are varied, it amounts to **reconstruction or reorganisation or scheme of arrangement.** In an amalgamation, two or more companies are fused into one by merger or by one taking over the other.

Amalgamation is a blending of two or more existing undertakings into one undertaking, the shareholders of each blending company become substantially the shareholders of the company which is to carry on the blended undertaking.

There may be amalgamation either by the transfer of two or more undertakings to a new company, or by the transfer of one or more undertaking to an existing compnay. Strictly, 'amalgamation' does not cover the mere acquisition by a company of the share capital of the other company which remains in existence and continues its undertaking but the context in which the term is used may show that it is intended to include such an acquisition."

A merger is generally understood to be a fusion of two companies. The term "merger" means and signifies the dissolution of one or more companies or firms or proprietorships to form or get absorbed into another company. By concept, merger increases the size of the undertakings. The two companies which have merged are in the same industry, normally the market share of the new consolidated company would be larger and it is possible that it may move closer to being a monopoly or a near monopoly. This is known as **horizontal** merger.

On the other hand, **vertical** merger means the merger of two companies which are in different field altogether, the coming together of two concerns may give rise to a situation similar to a monopoly. But there is yet another type of merger known as **reverse merger**, where, in order to avail benefit of carry forward of losses which are available according to tax law only to the company which had incurred them, the profit making company is merged with companies having accumulated losses.

2. CONGLOMERATE MERGERS:

Such mergers involve firms engaged in unrelated type of business operations. In other words, the business activities of acquirer and the target are not related to each other horizontally (i.e., producing the same or competiting products) nor vertically (Having relationship of buyer and supplier). In a pure conglomerate merger, there are no important common factors between the companies in production, marketing, research and development and technology.

There may however be some degree of overlapping in one or more of these common factors. Such mergers are in fact, unification of different kinds of businesses under one flagship company. The purpose of merger remains utilization of financial resources, enlarged debt capacity and also synergy of managerial functions.

3. CONGENERIC MERGER:

In these mergers, the acquirer and the target companies are related through basic technologies, production processes or markets. The acquired company represents an extension of product-line, market participants or technologies of the acquirer. These mergers represent an outward movement by the acquirer from its current business scenario to other related business activities.

4. REASONS AND RATIONALE FOR MERGERS AND ACQUISITIONS:

The most common reasons for Mergers and Acquisition (M&A) are:

a) Synergistic operating economics:

Synergy May be defined as follows:

$V(AB) > V(A) + V(B)$.

In other words the combined value of two firms or companies shall be more than their individual value. This may be result of complimentary services economics of scale or both.

A good example of complimentary activities can a company may have a good networking of branches and other company may have efficient production system. Thus the merged companies will be more efficient than individual companies.

On Similar lines, economics of large scale is also one of the reason for synergy benefits. The main reason is that, the large scale production results in lower average cost of production e.g. reduction in overhead costs on account of sharing of central services such as accounting and finances, Office executives, top level management, legal, sales promotion and advertisement etc.

These economics can be "real" arising out of reduction in factor input per unit of output, whereas pecuniary economics are realized from paying lower prices for factor inputs to bulk transactions.

b) DIVERSIFICATION:

In case of merger between two unrelated companies would lead to reduction in business risk, which in turn will increase the market value consequent upon the reduction in discount rate/ required rate of return.

Normally, greater the combination of statistically independent or negatively correlated income streams of merged companies; these will be higher reduction in the business in comparison of companies having income stream dependent cash stream.

c) TAXATION:

The provision of "set off and carry forward of losses" as per Income Tax Act may be another strong season for the merger cud acquisition. Thus, there will be Tax saving or reduction in tax liability of the mergered firm having substantial earning.

Similarly the case of acquisition the losses of the target company will be allowed to be set off against the profits of the acquiring company.

d) GROWTH:

Merger and acquisition mode enable the firm to grow at a rate faster than other mode e.g. capital budgeting, because the merged or acquiring company enters into the market. Quickly, avoiding delays such attached with purchasing of building, site, setting up of the plant and hiring personnel etc.

e) CONSOLIDATION OF PRODUCTION CAPACITIES AND INCREASING MARKET POWER:

Due to reduction in competition market power increases and also the production capacities are increased by combined of two or more plants.

5. PROBLEMS FOR M & A IN INDIA:

a) Indian corporate are largely promoter-controlled and managed. The ownership stake should, in the normal course, inhibit any rational judgement on this sensitive issue. It is difficult for either of the two promoters to voluntarily relinquish management control in favour of the other, as a merger between two companies implies. The other problems in this respect may be like.

b) In some cases, the need for prior negotiations and concurrence of financial institutions and banks is an added rider, besides SEBI's rules and regulations.

c) The reluctance of financial institutions and banks to fund acquisitions directly.
d) The BIFR route, although tedious, is preferred for obtaining financial concessions.
e) Lack of Exit Policy for restructuring/downsizing.
f) Absence of efficient capital market system makes the Market capitalization not fair in some cases.
g) Valuation is still evolving in India.

6. **Mergers in specific sectors:**

The Companies Act, 2013 and the SEBI's Takeover Code are the general source of guidelines governing merges. There are sector specific legislative provisions, which to a limited extent empower the regulator to promote competition.

For example, the Electricity Regulatory Commission has been given powers under the Electricity Act, 2003 to promote competition.

Also in the Telecom and broadcasting Regulatory Authority of India (TRAI) Regulate mergers in these sectors and any dispute regarding the same is adjudicated by the Telecom Dispute Settlement Appellate Tribunal (TDSAT). Guidelines for (intra-circle mergers intra-circle mergers means mergers, of telecom service providers within the same geographical area or zone of operation) are also formulated by the TRAI.

In addition to the above authorities, approval may also be required from other sector-specific authorities. Mergers in the banking sector require approval from the RBI

7. **ACQUISITION OR TAKEOVER MAY BE BY WAY OF,**

a) Acquisition of Companies shares.
b) Acquisition of business assets (ABOs).
c) Acquisition of Brand's.
d) Acquisition of Companies by Friendly vs. Hostile takeover.
e) Reverse acquisition

Acquisition of one of the business of a company, as a going concern by an agreement need not necessarily be routed through court, if the transfer of business is to be accomplished without allotting shares in the transferee company to the shareholders of the transferor company. This would tantamount to a simple acquisition. In this case the transferor company continues to exist and no change in shareholding is expected.

If the sale takes place for a lumpsum consideration without attributing any individual values to any class of assets, such sales are called slump sales. The capital gains arising on slump sales were being exempt from income tax based on a decision of the Supreme Court of India.

An acquisition by purchase of a controlling interest in the share capital of another existing company **is takeover, another term for acquisition.** The two types of takeovers are:

a) FRIENDLY TAKEOVER:

Takeover through negotiations and with willingness and consent of the acquired company's Board of directors.

b) HOSTILE TAKEOVER:

An acquirer company may not offer to target company the proposal to acquire its undertaking but silently and unilaterally pursue efforts to gain control in it against the wishes of the management.

8. TAKE OVER STRATEGIES:

Other than tender offer the acquiring company can also use the following techniques:

a) STREET SWEEP:

This refers to the technique where the acquiring company accumulates larger number of shares in a target before making an open offer. The advantage is that the target company is left with no choice but to agree to the proposal of acquirer for takeover.

b) Bear Hug:

When the acquirer threatens the target to make an open offer, the board of Target Company agrees to a settlement with the acquirer for change of control.

c) STRATEGIC ALLIANCE:

This involves disarming the acquirer by offering a partnership rather than a buyout. The acquirer should assert control from within and takeover the target company.

d) BRAND POWER:

This refers to entering into an alliance with powerful brands to displace the target's brands and as a result, buyout the weakened company.

9. LEGAL ASPECTS OF MERGER & ACQUISITION (M & A):

Merger control requirements in India are currently governed by the provisions of the Companies Act, 2013 and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. ("The takeover code"). The provisions of the Takeover Code apply only to acquisition of shares in listed public companies. Although there is no definition of amalgamation or mergers in the Indian Companies Act, it is understood to mean an arrangement by which transfer of undertakings is affected.
Sections 230 to 240 of the Companies Act, 2013 deals with such an arrangement. Other statue which governs merger proposals is the Industries (Development and Regulation) Act, 1951; the Foreign Exchange Management Act, 2000, the Income Tax Act, 1961 and the SEBI Act, 1992.

10. CROSS-BORDER MERGER & ACQUISITION (M & A):

Cross-border M&A is a popular route for global growth and overseas expansion. Cross-border M&A is also playing an important role in global M&A. This is especially true for developing countries such as India.
The 1992 completion of the European Union's Internal Market stimulated many of these investments, as European, Japanese, and US firms jockeyed for stronger market positions within the EU. However, the long-run US growth prospects and political safety in the United States motivated more takeovers of US firms by foreign firms, particularly from the United Kingdom and Japan, than vice versa.
Other major factors that motivate multinational companies to engage in cross-border M&A in Asia include the following:

a) Globalization of production and distribution of products and services.
b) Integration of global economies.
c) Expansion of trade and investment relationships on International level.
d) Many countries are reforming their economic and legal systems, and providing generous investment and tax incentives to attract foreign investment.
e) Privatization of state-owned enterprises and consolidation of the banking industry.

11. CONCLUSION:

Amalgamation is effected basically for growth and sometimes for image. Some of the objectives for which amalgamation may be resorted to are:

- Horizontal growth to achieve optimum size, to enlarge the market share, to curb competition or to use unutilized capacity;
- Vertical combination with a view to economizing costs and eliminating avoidable sales - tax and/or excise duty;
- Diversification of business;
- Mobilizing financial resources by utilising the idle funds lying with another company for the expansion of business. (For example, nationalization of banks provided this opportunity and the erstwhile banking companies merged with industrial companies);
- Merger of an export, investment or trading company with an industrial company or vice versa with a view

to increasing cash flow;

- Merging subsidiary company with the holding company with a view to improving cash flow;
- Taking over a 'shell' company which may have the necessary industrial licenses etc., but whose promoters do not wish to proceed with the project.

An amalgamation may also be resorted to for the purpose of nourishing a sick unit in the group and this is normally a merger for keeping up the image of the group.

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