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Mergers and Acquisitions in India

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Abstract:
In this paper our aim to discuss various modes Merger & Acquisitions in India as well as in the world. What are the benefit and limitations of Merger & Acquisitions. How Merger & Acquisitions are regulated through The Companies Act, 1956 and The Competition Act, 2002. Tax Impact of Merger & Acquisitions. We also explained various types of accounting of Merger & Acquisitions and its effect over Indian economy. We also discussed how Importance of India is growing in World Trade.

Keywords: *Merger and Acquisitions, Security Exchange Board of India (SEBI), The Income Tax Act 1961, The Company Act 1956, The Competition Act 2002*

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1. Introduction

A merger is a combination of two or more businesses into one business. Laws in India use the term 'amalgamation' for merger. The Income Tax Act, 1961 [Section 2(1A)] defines amalgamation as the merger of one or more companies with another or the merger of two or more companies to form a new company, in such a way that all assets and liabilities of the amalgamating companies become assets and liabilities of the amalgamated company and shareholders not less than nine-tenths in value of the shares in the amalgamating company or companies become shareholders of the amalgamated company.

An acquisition may be defined as an act of acquiring effective control by one company over assets or management of another company without any combination of companies. Thus, in an acquisition two or more companies may remain independent, separate legal entities, but there may be a change in control of the companies. When an acquisition is 'forced' or 'unwilling', it is called a takeover. In an unwilling acquisition, the management of 'target' company would oppose a move of being taken over. But, when managements of acquiring and target companies mutually and willingly agree for the takeover, it is called acquisition or friendly takeover.

Under the Monopolies and Restrictive Practices Act, takeover meant acquisition of not less than 25 percent of the voting power in a company. While in the Companies Act (Section 372), a company's investment in the shares of another company in excess of 10 percent of the subscribed capital can result in takeovers. An acquisition or takeover does not necessarily entail full legal control. A company can also have effective control over another company by holding a minority ownership.

2. Objective of Study

Objective of this paper is to study the various modes of mergers and acquisitions and the various modes of mergers and acquisitions in India. We also discussed the effect of competition act 2002 introduced in India and Tax aspects of mergers and acquisitions. We also explained

various methods of accounting of mergers and acquisitions and effect over Indian economy. Growing importance of Indian economy in world trade.

3. Review Literature

A merger is a combination of two or more businesses into one business. Laws in India use the term 'amalgamation' for merger. The **Income Tax Act,1961 [Section 2(1A)]**defines amalgamation as the merger of one or more companies with another or the merger of two or more companies to form a new company, in such a way that all assets and liabilities of the amalgamating companies become assets and liabilities of the amalgamated company and shareholders not less than nine-tenths in value of the shares in the amalgamating company or companies become shareholders of the amalgamated company.

Thus, mergers or amalgamations may take two forms:-

- Merger through Absorption**: -** An absorption is a combination of two or more companies into an 'existing company'. All companies except one lose their identity in such a merger. For example, absorption of Tata Fertilizers 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. TFL transferred its assets, liabilities and shares to TCL.
- Merger through Consolidation**: -** A consolidation is a combination of two or more companies into a 'new company'. In this form of merger, all companies are legally dissolved and a new entity is created. Here, the acquired company transfers its assets, liabilities and shares to the acquiring company for cash or exchange of shares. For example, merger of Hindustan Computers Ltd, Hindustan Instruments Ltd, Indian Software Company Ltd and Indian Reprographics Ltd into an entirely new company called HCL Ltd.
- A fundamental characteristic of merger (either through absorption or consolidation) is that the acquiring company (existing or new) takes over the ownership of other companies and combines their operations with its own operations.

Besides, there are three major types of mergers:

- Horizontal merger: **-** is a combination of two or more firms in the same area of business. For example, combining of two book publishers or two luggage manufacturing companies to gain dominant market share.
- Vertical merger**: -** is a combination of two or more firms involved in different stages of production or distribution of the same product. For example, joining of a TV manufacturing (assembling) company and a TV marketing company or joining of a spinning company and a weaving company. Vertical merger may take the form of forward or backward merger. When a company combines with the supplier of material, it is called backward merger and when it combines with the customer, it is known as forward merger.
- Conglomerate merger**: -** is a combination of firms engaged in unrelated lines of business activity. For example, merging of different businesses like manufacturing of cement products, fertilizer products, electronic products, insurance investment and advertising agencies. L&T and Voltas Ltd are examples of such mergers.

3.1 Acquisitions and Takeovers

An acquisition may be defined as an act of acquiring effective control by one company over assets or management of another company without any combination of companies. Thus, in an acquisition two or more companies may remain independent, separate legal entities, but there may be a change in control of the companies. When an acquisition is 'forced' or 'unwilling', it is called a takeover. In an unwilling acquisition, the management of 'target' company would oppose a move of being taken over. But, when managements of acquiring and target companies mutually and willingly agree for the takeover, it is called acquisition or friendly takeover.

Under **the Monopolies and Restrictive Practices Act**, takeover meant acquisition of not less than 25 percent of the voting power in a company. While in **the Companies Act (Section 372)**, a company's investment in the shares of another company in excess of 10 percent of the subscribed capital can result in takeovers. An acquisition or takeover does not necessarily entail full legal control. A company can also have effective control over another company by holding a minority ownership.

3.2 Advantages of Mergers & Acquisitions

The most common motives and advantages of mergers and acquisitions are:-

- Accelerating a company's growth, particularly when its internal growth is constrained due to paucity of resources. Internal growth requires that a company should develop its operating facilities- manufacturing, research, marketing, etc. But, lack or inadequacy of resources and time needed for internal development may constrain a company's pace of growth. Hence, a company can acquire production facilities as well as other resources from outside through mergers and acquisitions. Specially, for entering in new products/markets, the company may lack technical skills and may require special marketing skills and a wide distribution network to access different segments of markets. The company can acquire existing company or companies with requisite infrastructure and skills and grow quickly.
- Enhancing profitability because a combination of two or more companies may result in more than average profitability due to cost reduction and efficient utilization of resources. This may happen because of:
  - **Economies of scale:** Arise when increase in the volume of production leads to a reduction in the cost of production per unit. This is because, with merger, fixed costs are distributed over a large volume of production causing the unit cost of production to decline. Economies of scale may also arise from other indivisibilities such as production facilities, management functions and management resources and systems. This is because a given function, facility or resource is utilized for a large scale of operations by the combined firm.
  - **Operating economies:** Arise because, a combination of two or more firms may result in cost reduction due to operating economies. In other words, a combined firm may avoid or reduce over-lapping functions and consolidate its management functions such as manufacturing, marketing, R&D and thus reduce operating costs. For example, a combined firm may eliminate duplicate channels of distribution, or crate a centralized training center, or introduce an integrated planning and control system.
  - **Synergy:** Implies a situation where the combined firm is more valuable than the sum of the individual combining firms. It refers to benefits other than those related to economies of scale. Operating economies are one form of synergy benefits. But apart from operating economies, synergy may also arise from enhanced managerial capabilities, creativity, innovativeness, R&D and market coverage capacity due to the complementarily of resources and skills and a widened horizon of opportunities.

Diversifying the risks of the company, particularly when it acquires those businesses whose income streams are not correlated. Diversification implies growth through the combination of firms in unrelated businesses. It results in reduction of total risks through substantial reduction of cyclicality of operations. The combination of management and other systems strengthen the capacity of the combined firm to withstand the severity of the unforeseen economic factors which could otherwise endanger the survival of the individual companies.

A merger may result in financial synergy and benefits for the firm in many ways:

- By eliminating financial constraints
- By enhancing debt capacity. This is because a merger of two companies can bring stability of cash flows which in turn reduces the risk of insolvency and enhances the capacity of the new entity to service a larger amount of debt

- By lowering the financial costs. This is because due to financial stability, the merged firm is able to borrow at a lower rate of interest.

Limiting the severity of competition by increasing the company's market power. A merger can increase the market share of the merged firm. This improves the profitability of the firm due to economies of scale. The bargaining power of the firm vis-à-vis labour, suppliers and buyers is also enhanced. The merged firm can exploit technological breakthroughs against obsolescence and price wars.

3.3 Regulations for Mergers & Acquisitions

Mergers and acquisitions are regulated under various laws in India. The objective of the laws is to make these deals transparent and protect the interest of all shareholders. They are regulated through the provisions of:-

3.4 The Companies Act, 1956

The Act lays down the legal procedures for mergers or acquisitions :-

- **Permission for merger:-** Two or more companies can amalgamate only when the 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 memorandum of association, 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.
- **Approval of board of directors:-** The board of directors of the individual companies should approve the draft proposal for amalgamation and authorise the managements of the companies to further pursue the proposal.
- **Application in the High Court:-** An application for approving the draft amalgamation proposal duly approved by the board of directors of the individual companies should be made to the High Court.
- **Shareholders' and creators' meetings:-** The individual companies should hold separate meetings of their shareholders and creditors for approving the amalgamation scheme. At least, 75 percent of shareholders and creditors in separate meeting, voting in person or by proxy, must accord their approval to the scheme.
- **Sanction by the High Court:-** After the approval of the shareholders and creditors, on the petitions of the companies, the High Court will pass an order, sanctioning the amalgamation scheme after it is satisfied that the scheme is fair and reasonable. The date of the court's hearing will be published in two newspapers, and also, the regional director of the Company Law Board will be intimated.
- **Filing of the Court order:-** After the Court order, its certified true copies will be filed with the Registrar of Companies.
- **Transfer of assets and liabilities:-** The assets and liabilities of the acquired company will be transferred to the acquiring company in accordance with the approved scheme, with effect from the specified date.
- **Payment by cash or securities:-** 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.

3.5 The Competition Act, 2002

The Act regulates the various forms of **business combinations** through **Competition Commission of India**. Under the Act, no person or enterprise shall enter into a combination, in

the form of an acquisition, merger or amalgamation, which causes or is likely to cause an appreciable adverse effect on competition in the relevant market and such a combination shall be void. Enterprises intending to enter into a combination may give notice to the Commission, but this notification is voluntary. But, all combinations do not call for scrutiny unless the resulting combination exceeds the threshold limits in terms of assets or turnover as specified by the Competition Commission of India. The Commission while regulating a 'combination' shall consider the following factors:-

- Actual and potential competition through imports;
- Extent of entry barriers into the market;
- Level of combination in the market;
- Degree of countervailing power in the market;
- Possibility of the combination to significantly and substantially increase prices or profits;
- Extent of effective competition likely to sustain in a market;
- Availability of substitutes before and after the combination;
- Market share of the parties to the combination individually and as a combination;
- Possibility of the combination to remove the vigorous and effective competitor or competition in the market;
- Nature and extent of vertical integration in the market;
- Nature and extent of innovation;
- Whether the benefits of the combinations outweigh the adverse impact of the combination.

Thus, the Competition Act does not seek to eliminate combinations and only aims to eliminate their harmful effects. The other regulations are provided in the: - **The Foreign Exchange Management Act, 1999** and **the Income Tax Act, 1961**. Besides, the **Securities and Exchange Board of India (SEBI)** has issued guidelines to regulate mergers and acquisitions. The **SEBI (Substantial Acquisition of Shares and Take-overs) Regulations, 1997** and **its subsequent amendments** aim at making the take-over process transparent, and also protect the interests of minority shareholders.

4. Conclusion

In the end we can say that, there are various modes of Merger & Acquisitions which helped many times to a company which want to do business in new place and don't have any idea or knowledge about new place, Then these methods helped many times to these types of firms and they merged with local firms which helps them to do the business in unknown market. A weak company can perform well after merging with good company which give them good management system as well as financial support. New technology and R&D is also received by a company which is merged to other developed firm. Merger & Acquisitions also give synergy, financial support and Economies of scale to the company, But we have also to keep in mind the various regulation acts in mind at the of Merger & Acquisitions.

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