A CRITICAL STUDY OF MERGERS & ACQUISITION OF COMPANIES IN INDIA

A DISSERTATION TO BE SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF DEGREE OF MASTER OF LAWS

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I wish him success in life.

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ACKNOWLEDGEMENT

This dissertation is the outcome of the study by the Author. Any material used from different sources has been thoroughly acknowledged. After the successful completion of my work, I would like to thank number of people.

I would like to give my heartfelt gratitude to **Ms. Mudita Tripathi, Assistant Professor, School of Legal Studies** who undertook the role of supervisor, mentor, and guide for the successful preparation of this dissertation. This work is an outcome of an unparallel infrastructural support that I have received from staff and employees of institute of legal studies. It would never have been possible to complete this study without an untiring support from my family.

Finally, I must express my very profound gratitude to my parents for providing me with unfailing support and continuous encouragement throughout my years of study and through the process of researching and writing this dissertation. This accomplishment would not have been possible without them. This study bears testimony to the active encouragement and guidance of a host of friends and well-wishers.

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LIST OF ABBREVIATIONS

SEBI : Securities and Exchange Board of India, 1994

ITA : Income Tax Act, 1961

ISA : Indian Stamp Act, 1899

FEMA : Foreign Exchange Management Act, 1999

CB : Company Bill, 2011

CA : The Company Act, 1956

CA : The Competition Act, 2002

IDA : The Industrial Dispute Act 1947

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- Miheer H. Mafatlal vs. Mafatlal Industries Ltd. (AIR1997SC506)
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CHAPTER 1
INTRODUCTION

"Much of what is called investment is actually nothing more than mergers and acquisitions, and of course mergers and acquisitions are generally accompanied by downsizing."

- Susan George

1.1 INTRODUCTION

Merger and Acquisition have been a restricting strategy incorporated by Companies to drive growth increase access to capital Market. It is method by which two or more companies are combined to form a completely new company or where in one of the companies ceases to exist and becomes part of the other company. The macroeconomic environment, which includes the growth in GDP, interest rates and monetary policies play a key role in designing the process of mergers and Acquisition. The key principle behind buying a company is to enhance shareholder value. Create synergies and improve operating efficiency. However history would show us that the results of this strategy in terms of thesis will critically evaluate the underlying motivations of various companies in their attempt to achieve successful return to shareholders through this corporate restricting activity the researcher presents primary date in the source of three in depth interviews with corporate management that have had various results with of Merger and Acquisition activity in. provide a frame work for ascertaining the key driving and motivating factors for entering into Merger and Acquisition how they impact the outcome this date will be evaluated in combination with certain environmental factors that will be brought into consideration such as merger momentum to provide conclusive evidence on how positive drivers such as the creation of true operating synergies and more intangible factor as human capital play a more silent role in the success of such merger and acquisitions it is used by a business strategy for achieving economics of scale, to penetrate new markets, to combat competition they are a financial tool that is used for in enhancing long-term profitability by expanding business operation. They could be mergers with related companies or with companies which have completely different product line. They have become increasingly popular due to opening up of the different economics technological developments and the cut-throat competition in the business environment. The question that will be hypothesized will be whether or not true sustainable shareholder value is invariable created through this activity or whether markets invariable overestimate the returns to

shareholders particularly of the target firm in the short. Term creating transient that eventually disappears. We have been learning about the companies coming together to from another company and companies taking over the existing companies to expand their business.

With recession taking toll of many Indian businesses and the feeling of insecurity surging over our businessmen, it is not surprising when we hear about the immense numbers of corporate restructurings taking place, especially in the last couple of years. Several companies have been taken over and several have undergone internal restructuring, whereas certain companies in the same field of business have found it beneficial to merge together into one company.

In this context, it would be essential for us to understand what corporate restructuring and mergers and acquisitions are all about. The phrase mergers and acquisitions (abbreviated M&A) 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.

Thus, important issues both for business decision and public policy formulation have been raised. No firm is regarded safe from a takeover possibility. On the more positive side Mergers and Acquisition's may be critical for the healthy expansion and growth of the firm. Successful entry into new product and geographical markets may require Mergers and Acquisitions at some stage in the firm's development.

Successful competition in international markets may depend on capabilities obtained in a timely and efficient fashion through Mergers and Acquisitions. Many have argued that mergers increase value and efficiency and move resources to their highest and best uses, thereby increasing shareholder value. To opt for a merger or not is a complex affair, especially in terms of the technicalities involved. We have discussed almost all factors that the management may have to look into before going for merger. Considerable amount of brainstorming would be required by the managements to reach a conclusion. e.g., a due diligence report would clearly identify the status of the company in respect of the financial position along with the net worth and pending legal matters and details about various contingent liabilities. Decision has to be taken after having discussed the pros & cons of the proposed merger & the impact of the same on the business, administrative costs benefits, addition to shareholders' value, tax implications including stamp duty and last but not the least also on the employees of the Transferor or Transferee Company.

MERGER

Merger is defined as combination of two or more companies into a single company where one survives and the others lose their corporate existence. The survivor acquires all the assets as well as liabilities of the merged company or companies. Generally, the surviving company is the buyer, which retains its identity, and the extinguished company is the seller.

Merger is also defined as amalgamation. Merger is the fusion of two or more existing companies. All assets, liabilities and the stock of one company stand transferred to Transferee Company in consideration of payment in the form of:

- Equity shares in the transferee company,
- Debentures in the transferee company,
- Cash, or
- A mix of the above modes.

In business or economics, a merger is a combination of two companies into one larger company. Such actions are commonly voluntary and involve stock swap or cash payment to the target. Stock swap is often used as it allows the shareholders of the two companies to share the risk involved in the deal.

A merger can resemble a takeover but result in a new company name (often combining the names of the original companies) and in new branding; in some cases, terming the combination a "merger" rather than an acquisition is done purely for political or marketing reasons.

Merger is a financial tool that is used for enhancing long-term profitability by expanding their operations. Mergers occur when the merging companies have their mutual consent as different from acquisitions, which can take the form of a hostile takeover. The business laws in US vary across states and hence the companies have limited options to protect themselves from hostile takeovers. One way a company can protect itself from hostile takeovers is by planning shareholders rights, which is alternatively known as “poison pill.

If we trace back to history, it is observed that very few mergers have actually added to the share value of the acquiring company and corporate mergers may promote monopolistic practices by reducing costs, taxes etc.

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.

ACQUISITION

An Acquisition usually refers to a purchase of a smaller firm by a larger one. Acquisition, also known as a takeover or a buyout, is the buying of one company by another.

Acquisitions or takeovers occur between the bidding and the target company. There may be either hostile or friendly takeovers. Acquisition in general sense is acquiring the ownership in the property. In the context of business combinations, an acquisition is the purchase by one company of a controlling interest in the share capital of another existing company.

Methods of Acquisition:

An acquisition may be affected by

a) agreement with the persons holding majority interest in the company management like members of the board or major shareholders commanding
majority of voting power;
b) purchase of shares in open market;
c) to make takeover offer to the general body of shareholders;
d) purchase of new shares by private treaty;
e) Acquisition of share capital through the following forms of considerations viz. means of cash, issuance of loan capital, or insurance of share capital.

1.2 RESEARCH PROBLEM

In India this concept was started by Government bodies and some known financial institutions. Since 1991 the Indian economic reformer has opened up lot of challenges and competition from within and outside the counter the increased completion in the global market has led to the adaptation of the concept of merger by the Indian companies even though the Mergers and Acquisitions is a strategic choice in today's word no research has provided the confirmation of evidence whether they enhance the competence or destroy the wealth this paper explores the concept of Mergers and Acquisitions in

data the trends followed and all related sceneries

Mergers and Acquisitions and restricting have become a major force in the financial and economic environment all over the world. Essentially an American phenomenon till the middle of 1970 they have become a dominance global business theme at present on Indian scene too corporate are seriously making at merger acquisition which has become order of the day. The moment of Mergers and Acquisitions in India has changed over years. Now even the Indian enter pruners are acquiring foreign enterprises and the IT sectors in Indian have improved drastically are have showed their potential in the market globally the other sectors are no less.

1.3 AIMS AND OBJECTIVES OF THE STUDY

All Mergers & Acquisitions have one common goal they are all meant to create synergy that makes that value of the combined companies greater than the sum of the two parts the success of a Mergers and Acquisitions on depends on whether these synergies achieved.

In an attempt to uncover this information, the author proposes to present a set of answer to the following questions and objectives of the merger and acquisition it in defined as consolidation of companies with the objective of with maximization companies keep evaluating different opportunities through the route of merger or acquisitions.

- To critically assess the consequences of mergers and acquisitions on the operating performance of the companies in India.
- To strategically examine the effect on shareholder's wealth post-merger and acquisition.

1.4 RESEARCH HYPOTHESIS

The purpose of this research is as presented in the introduction to answer the following issues:

- Mergers improves the operating performance and shareholder wealth of the acquiring company.
-
- Mergers and Acquisitions cause no significant difference in the overall financial performance of a company

Further, the researcher aims to contribute with new research knowledge on M&As of companies in India

1.5 REVIEW OF LITERATURE

Various research paper has been studied about the effect of merger and acquisition of bank in India and compared pre and post-Merger position of selected banks and quested advantage and disadvantages of merger and acquisition of banks. Here are some following related review.

- Devarajapp S.(2012) analysed financial performance of HDFC Bank Limited and Centurion Bank of Punjab with the help of financial parameters and compared pre merger and post merger performance of banks on the basis of last 3 year data and the result of this analysis was that mean value of gross profit had increased and the mean value of equity had increased but there is no change in net profit, return on capital, and operating profit. And concluded that merger effect is helpful for surviving of week Bank by merging into larger banks.

- Dr K.A. Goyal & Vijay Joshi (2012) studied case of ICICI Bank Limited to be aware with the growth of ICICI Bank Limited. This Bank amalgamated with Nine Finance entities like SCICL, ITC Classic Finance Ltd., Anagram Finance, Bank of Madura, Bank of Sangali, ICICI Personal Finance Service Ltd & ICICI Capital Service Ltd., Standard of Chartered Grindlays Bank's two branches, and Bank of Rajasthan Ltd.. According to them merger and acquisition considered in three phases pre-merger phase, acquisition phase and post merger phase. And concluded that that there were many issues and challenges for ICICI Bank Limited but it accepted that challenges and became India's largest Private sector bank.

- It is founded from Gurubaksh Singh & Sunil Gupta's (2015) paper title "An impact of merger and acquisition on profitability of consolidation banking sector in India". analysed the performance of public and private sector bank with the data of last five year and evaluated pre and post-merger positions of bank through financial parameters like Arithmetic mean, standardization, t-test comma p-value. They found that merger and acquisition have positively impacted on merged Bank.

- Dr. Sangita Ghosh(2016) researched on merger between Global Trust Bank and Oriental Bank of Commerce. She analysed liquidity factor, efficiency factor, profitability factor and performance

factor of Oriental bank of commerce. And found that after merging bank profitability and efficiency of acquirer bank has improved but there was no change in liquidity position of oriental bank of commerce.

- Prof.Ritesh Patel(2014) examined finance and stock return of selected banks to know the effect after merger and concluded that merger and acquisition has positively impacted on Indian banks and told that some public sector banks is more advantageous rather than private sector bank.

- Parveen Kumari (2014) revealed in her paper merger and acquisition of bank as strategic approach and told that the aim of the merger and acquisition of bank is increase credit creation and make progressive. According to gathered post merger data she concluded that Number of branches & ATM, Net Profit, Deposit, Net Worth have increased.

- Prof. Ritesh Patel & Dr. Dharmesh Shah (2016) compared the financial performance of before and after merger of banks through Economic Value-added approach and through others financial parameters like mean score of net profit margin, return on net worth, return on assets, return on long term fund, interest earned and total assets. And told that its not necessary that EVA approach is common for all other bank. They concluded that financial performance of bank may be improved after merger. But if past financial data are examined before merger, it can make merger fruitful.

- Mehroz Nida Dilshad (2012)13 measured the efficiency of market with respect to announcements of mergers and acquisitions using an event study methodology. The study analyzed the effects of banks mergers and their announcements on the prices of stocks, in Europe. Evidence here supports those significant cumulative abnormal returns were short lived for the acquirers. At the end of the event window, the cumulative abnormal returns were zero. Evidence of excess returns after the merger announcement was also observed along with the leakage of information that resulted in the rise of stock prices few days before the announcement of merger or acquisition. At the same time, the results of cumulative abnormal returns showed that target banks earned abnormal returns on the merger announcement day.

- Annalisa Caruso and Fabrizio Palmucci analysed the market reaction to M&A in the banking sector, particularly interesting because of the higher complexity of corporate governance

and the importance that the M&A activity has had in recent years in Europe, especially in Italy. In this research they performed an event study on the Italian market (in the period 1994-2003) with two main goals: first they observe if and when there is a positive value creation, and when private benefits of control represent one of the drivers of the operations; secondly investigated the determinants of their results, looking at the characteristics of the banks, regulation, the role of minority shareholders and that of the Bank of Italy.

- Mathieu Luypaert empirically investigated the industry determinants of shareholder value creation in a sample of horizontal M&As in Europe during the period 1997–2006.The results show that industry concentration, industry-level operating performance, and the ratio of combined target and bidder size relative to the minimum efficient scale in the corresponding industry are significantly negatively related to the total value creation in M&As. The relation between industry sales growth and combined value creation is U-shaped. We also find some evidence that the value creation in M&As is significantly higher in recently deregulated industries. Finally, the data reveal that the distribution of M&A value between target and bidder investors is determined by firm-level variables rather than by industry characteristics.

- Dr. P. Natarajan and K. Kalaichelvan (2011)17 used the share price data and financial statements of eight select public and private sector banks, during the period between 1995 and 2004, this study examined M&A as a business strategy and to identify the relative importance of mergers on business performance and increased Shareholders wealth. The study showed that in a banking environment marked by frequent mergers, such transactions directly or indirectly effects the shareholders sentiments and increase market share (i.e.) mergers enhances performance and wealth for both the businesses and shareholders.

- Jianyu Ma et al (2009)18 investigated abnormal returns to shareholders of bidder firms around the day of M&A announcement for ten emerging Asian markets: China, India, Hong Kong, Indonesia, Malaysia, the Philippines, Singapore, South Korea, Taiwan, and Thailand. Using a sample of 1,477 M&A deals in the ten emerging Asian markets. Valuation effects of information leakage about M&A deals are statistically significant. The findings suggest that as investors reap the financial benefits associated with M&A deals, external growth through M&A activity may be

highly recommended to managers.

- Panayiotis Liargovas and Spyridon Repousis (2011) examined the impact of Greek mergers and acquisitions on the performance of the Greek Banking Sector during the period 1996-2009. With the use of event study methodology, we reject the "semi-strong form" of Efficient Market Hypothesis (EMH) of the Athens Stock Exchange. The overall results indicate that bank mergers and acquisitions have no impact and do not create wealth. They also examined operating performance of the Greek Banking Sector by estimating twenty financial ratios. Findings show that operating performance does not improve, following mergers and acquisitions. There are also controversial results when comparing merged to non-merged banks. Ahmad Ismail, Ian Davidson & Regina Frank (2009)20 concentrated on European banks and investigated post-merger operating performance and found that industry-adjusted mean cash flow return did not significantly change after merger but stayed positive. Also find that low profitability levels, conservative credit policies and good cost-efficiency status before merger are the main determinants of industry-adjusted cash flow returns and provide the source for improving these returns after merger. Results show that total factor productivity for merger banks for the period after merging can be attributed to an increase in technical inefficiency and the disappearance of economies of scale, while technical change remained unchanged compared to the pre-merging level.

- George E Halkos & Dimitrios (2004) applied non-parametric analytic technique (data envelopment analysis, DEA) in measuring the performance of the Greek banking sector. He proved that data envelopment analysis can be used as either an alternative or complement to ratio analysis for the evaluation of an organization's performance. However, analysis of the causes of failure has often been shallow and the measures of success weak. Ping-wen Lin (2002)22 findings proves that there is a negative correlation and statistical significance exist between cost inefficiency index and bank mergers; meaning banks engaging in mergers tend to improve cost efficiency. However, the data envelopment analysis empirical analysis found that bank mergers did not improve significantly cost efficiency of banks. In another study, he found that (1) generally; bank mergers tend to upgrade the technical efficiency, allocative efficiency, and cost efficiency of banks; however a yearly decline was noted in allocative efficiency and cost efficiency. (2) In terms of technical efficiency and allocative efficiency improvement, the effect of bank mergers was

significant; however, in terms of cost efficiency improvement, the effect was insignificant.

- Suchismita Mishra, Arun, Gordon and Manfred Peterson (2005) examined the contribution of the acquired banks in only the non-conglomerate types of mergers (i.e., banks with banks), and finds overwhelmingly statistically significant evidence that non conglomerate types of mergers definitely reduce the total as well as the unsystematic risk while having no statistically significant effect on systematic risk. Xiao Weiguo & Li Ming (2008) paper uses DEA (Data Envelopment Analysis) for analyzing commercial banks' efficiency, top five American banks and four Chinese banks and concluded that merger and acquisition (M&A) has greater impact on banking efficiency of Chinese banks than that of American banks. Robert DeYoung (1997) estimated pre- and post-merger X-inefficiency of mergers. Efficiency improved in only a small majority of mergers, and these gains were unrelated to the acquiring bank's efficiency advantage over its target. Efficiency gains were concentrated in mergers where acquiring banks made frequent acquisitions, suggesting the presence of experience effects. The study examines the efficiency consequences of bank mergers and acquisitions of Australian four major banks. The empirical results demonstrate that for the time being mergers among the four major banks may result in much poorer efficiency performance in the merging banks and the banking sector.

- Morris Knapp, Alan Gart & Mukesh Chaudhry (2006)25 research study examines the tendency for serial correlation in bank holding company profitability, finding significant evidence of reversion to the industry mean in profitability. The paper then considers the impact of mean reversion on the evaluation of post-merger performance of bank holding companies. The research concludes that when an adjustment is made for the mean reversion, post-merger results significantly exceed those of the industry in the first 5 years after the merger.

1.6 METHODOLOGY OF THE STUDY

Methodology describes the research methodology and the rational pursued by the researchers to construct the research layout and answer the research question. The researcher referred both the primary and the secondary data the amendment to the existing act judicial precedents by the courts are considered as primary data the information gather from books by different authors is taken as

secondary data various articles from websites which deals with company laws have also been referred.

Two types of data wear needed Firstly, data on Indian Mergers and Acquisitions is needed for the post 1991.period for effectively carrying out trend analysis thus the first task was to build a data base on Merger and Acquisition in Indian as there is no official data base available which gibes a complete picture of Merger and Acquisitions

Secondly, financial data was needed to examine the impact of Merger and Acquisition. Data collection- before testing the sources; from which data bank on Merger and Acquisition was created it is useful to understand the modus operand for Merger and Acquisition. In India as this gave the hint about the sources from which data on Merger and Acquisition could be obtained.

On an average, it takes about a year from the board meeting approving the merger scheme to getting the approval doctrinal methodology.

CHAPTER 2

MERGERS AND ACQUISITIONS: A CLASSIFICATION

2.1 CLASSIFICATIONS OF MERGERS

Horizontal mergers take place where the two merging companies produce similar product in the same industry. Horizontal mergers are those mergers where the company's manufacturing similar kinds of commodities or running similar type of businesses merge with each other. The principal objective behind this type of mergers is to achieve economies of scale in the production procedure through carrying off duplication of installations, services and functions, widening the line of products, decrease in working capital and fixed assets investment, getting rid of competition, minimizing the advertising expenses, enhancing the market capability and to get more dominance on the market.

Nevertheless, the horizontal mergers do not have the capacity to ensure the market about the product and steady or uninterrupted raw material supply. Horizontal mergers can sometimes result in monopoly and absorption of economic power in the hands of a small number of commercial entities[1].

According to strategic management and microeconomics, the expression horizontal merger delineates a form of proprietorship and control. It is a plan, which is utilized by a corporation or commercial enterprise for marketing a form of commodity or service in a large number of markets. In the context of marketing, horizontal merger is more prevalent in comparison to horizontal merger in the context of production or manufacturing.

2.1.1 Horizontal Integration

Sometimes, horizontal merger is also called as horizontal integration. It is totally opposite in nature to vertical merger or vertical integration.

Horizontal Monopoly

A monopoly formed by horizontal merger is known as a horizontal monopoly. Normally, a monopoly is formed by both vertical and horizontal mergers. Horizontal merger is that condition where a company is involved in taking over or acquiring another company in similar form of trade. In this way,

a

competitor is done away with and a wider market and higher economies of scale are accomplished.

In the process of horizontal merger, the downstream purchasers and upstream suppliers are also controlled and as a result of this, production expenses can be decreased.

Horizontal Expansion

An expression which is intimately connected to horizontal merger is horizontal expansion. This refers to the expansion or growth of a company in a sector that is presently functioning. The aim behind a horizontal expansion is to grow its market share for a specific commodity or service.

Examples of Horizontal Mergers

Following are the important examples of horizontal mergers:

- The formation of Brook Bond Lipton India Ltd. through the merger of Lipton India and Brook Bond
- The merger of Bank of Mathura with ICICI (Industrial Credit and Investment Corporation of India) Bank
- The merger of BSES (Bombay Suburban Electric Supply) Ltd. with Orissa Power Supply Company

2.1.2 Vertical mergers occur when two firms, each working at different stages in the production of the same good, combine.

Congeneric mergers occur where two merging firms are in the same general industry, but they have no mutual buyer/customer or supplier relationship, such as a merger between a bank and a leasing company. Example: Prudential's acquisition of Bache & Company.

Conglomerate mergers take place when the two firms operate in different industries. A unique type of merger called a reverse merger is used as a way of going public without the expense and time required by an IPO.

The occurrence of a merger often raises concerns in antitrust circles. Devices such as the Herfindahl index can analyze the impact of a merger on a market and what, if any, action could prevent it.

Regulatory bodies such as the European Commission, the United States Department of Justice and the U.S. Federal Trade Commission may investigate anti-trust cases for monopolies dangers, and have the power to block mergers.

Accretive mergers are those in which an acquiring company's earnings per share (EPS) increase. An alternative way of calculating this is if a company with a high price to earnings ratio (P/E) acquires one with a low P/E.

Dilutive mergers are the opposite of above, whereby a company's EPS decreases. The company will be one with a low P/E acquiring one with a high P/E.

The completion of a merger does not ensure the success of the resulting organization; indeed, many mergers (in some industries, the majority) result in a net loss of value due to problems. Correcting problems caused by incompatibility—whether of technology, equipment, or corporate culture—diverts resources away from new investment, and these problems may be exacerbated by inadequate research or by concealment of losses or liabilities by one of the partners. Overlapping subsidiaries or redundant staff may be allowed to continue, creating inefficiency, and conversely the new management may cut too many operations or personnel, losing expertise and disrupting employee culture. These problems are similar to those encountered in takeovers. For the merger not to be considered a failure, it must increase shareholder value faster than if the companies were separate, or prevent the deterioration of shareholder value more than if the companies were separate.[7]

Distinction between Mergers and Acquisitions

Although they are often uttered in the same breath and used as though they were synonymous, the terms merger and acquisition mean slightly different things.

1) When one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition. 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.

2) In the pure sense of the term, a merger happens when two firms, often of about the same size, 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". Both companies' stocks are

surrendered and new company stock is issued in its place. For example, both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created.

3) 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.

4) 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.

5) Whether a purchase is considered a merger or an acquisition really depends on whether the purchase is friendly or hostile and how it is announced. In other words, the real difference lies in how the purchase 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 (Harwood, 2005).

When companies are merging & acquisition, they valuate the business

Business valuation

The five most common ways to valuate a business are:

1. Asset valuation
2. Historical earnings valuation
3. Future maintainable earnings valuation
4. Relative valuation (comparable company & comparable transactions)
5. Discounted cash flow (DCF) valuation.

Professionals who valuate businesses generally do not use just one of these methods but a combination of some of them, as well as possibly others that are not mentioned above, in order to obtain a more accurate value. These values are determined for the most part by looking at a company's balance sheet and/or income statement and withdrawing the appropriate information. The information in the balance sheet or income statement is obtained by one of three accounting measures: a Notice to Reader, a

Review Engagement or an Audit.

Accurate business valuation is one of the most important aspects of M&A (Merger and Acquisitions) as valuations like these will have a major impact on the price that a business will be sold for. Most often this information is expressed in a Letter of Opinion of Value (LOV) when the business is being evaluated for interest's sake. There are other, more detailed ways of expressing the value of a business. These reports generally get more detailed and expensive as the size of a company increases; however, this is not always the case as there are many complicated industries which require more attention to detail, regardless of size.

2.2 FINANCING MERGER & ACQUISITION

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 alone. A cash deal would make more sense during a downward trend in the interest rates. Another advantage of using cash for an acquisition is that there tends to lesser chances of EPS dilution for the acquiring company. But a caveat in using cash is that it places constraints on the cash flow of the company.

Financing

Financing capital may be borrowed from a bank, or raised by an issue of bonds. Alternatively, the acquirer's stock may be offered as consideration.

Hybrids

An acquisition can involve a combination of cash and debt, or a combination of cash and stock of the purchasing entity. Factoring can provide the necessary extra to make a merger or sale work.

2.3 EFFECTS ON MANAGEMENT

A study published in the July/August 2008 issue of the Journal of Business Strategy suggests that mergers and acquisitions destroy leadership continuity in target companies' top management teams for at least a decade following a deal. The study found that target companies lose 21 percent of their executives each year for at least 10 years following an acquisition – more than double the turnover

experienced in non-merged firms.

2.4 THE GREAT MERGER MOVEMENT OF MERGER & ACQUISITION

The Great Merger Movement was a predominantly U.S. business phenomenon that happened from 1895 to 1905. During this time, small firms with little market share consolidated with similar firms to form large, powerful institutions that dominated their markets. It is estimated that more than 1,800 of these firms disappeared into consolidations, many of which acquired substantial shares of the markets in which they operated. The vehicle used were so-called trusts. To truly understand how large this movement was—in 1900 the value of firms acquired in mergers was 20% of GDP. In 1990 the value was only 3% and from 1998–2000 it was around 10–11% of GDP. Organizations that commanded the greatest share of the market in 1905 saw that command disintegrate by 1929 as smaller competitors joined forces with each other. However, there were companies that merged during this time such as DuPont, Nabisco, US Steel, and General Electric that have been able to keep their dominance in their respected sectors today due to growing technological advances of their products, patents, and brand recognition by their customers. These companies that merged were consistently mass producers of homogeneous goods that could exploit the efficiencies of large volume production. Companies which had specific fine products, like fine writing paper, earned their profits on high margin rather than volume and took no part in Great Merger Movement.

2.5 SHORT-RUN FACTORS

One of the major short run factors that sparked in The Great Merger Movement was the desire to keep prices high. That is, with many firms in a market, supply of the product remains high. During the panic of 1893, the demand declined. When demand for the good falls, as illustrated by the classic supply and demand model, prices are driven down. To avoid this decline in prices, firms found it profitable to collude and manipulate supply to counter any changes in demand for the good. This type of cooperation led to widespread horizontal integration amongst firms of the era. Focusing on mass production allowed firms to reduce unit costs to a much lower rate. These firms usually were capital-intensive and had high fixed costs. Because new machines were mostly financed through bonds, interest payments on bonds were high followed by the panic of 1893, yet no firm was willing to accept quantity reduction during this period.

2.6 LONG-RUN FACTORS

In the long run, due to the desire to keep costs low, it was advantageous for firms to merge and reduce their transportation costs thus producing and transporting from one location rather than various sites of different companies as in the past. This resulted in shipment directly to market from this one location. In addition, technological changes prior to the merger movement within companies increased the efficient size of plants with capital intensive assembly lines allowing for economies of scale. Thus, improved technology and transportation were forerunners to the Great Merger Movement. In part due to competitors as mentioned above, and in part due to the government, however, many of these initially successful mergers were eventually dismantled. The U.S. government passed the Sherman Act in 1890, setting rules against price fixing and monopolies. Starting in the 1890s with such cases as U.S. versus Addyston Pipe and Steel Co., the courts attacked large companies for strategizing with others or within their own companies to maximize profits. Price fixing with competitors created a greater incentive for companies to unite and merge less than one name so that they were not competitors anymore and technically not price fixing.

2.7 CROSS-BORDER M&A MERGERS AND ACQUISITIONS

In a study conducted in 2000 by Lehman Brothers, it was found that, on average, large M&A deals cause the domestic currency of the target corporation to appreciate by 1% relative to the acquirers. For every $1-billion deal, the currency of the target corporation increased in value by 0.5%. More specifically, the report found that in the period immediately after the deal is announced, there is generally a strong upward movement in the target corporation's domestic currency (relative to the acquirer's currency). Fifty days after the announcement, the target currency is then, on average, 1% stronger.

The rise of globalization has exponentially increased the market for cross border M&A. In 1996 alone there were over 2000 cross border transactions worth a total of approximately $256 billion. This rapid increase has taken many M&A firms by surprise because the majority of them never had to consider acquiring the capabilities or skills required to effectively handle this kind of transaction. In the past, the market's lack of significance and a more strictly national mindset prevented the vast majority of small and mid-sized companies from considering cross border intermediation as an option which left M&A firms inexperienced in this field. This same reason also prevented the development of any extensive academic works on the subject.

Due to the complicated nature of cross border M&A, the vast majority of cross border actions have unsuccessful results. Cross border intermediation has many more levels of complexity to it than regular intermediation seeing as corporate governance, the power of the average employee, company regulations, political factors customer expectations, and countries' culture are all crucial factors that could spoil the transaction. However, with the weak dollar in the

U.S. and soft economies in a number of countries around the world, we are seeing more cross- border bargain hunting as top companies seek to expand their global footprint and become more agile at creating high-performing businesses and cultures across national boundaries. Even mergers of companies with headquarters in the same country are very much of this type (cross-border Mergers). After all, when Boeing acquires McDonnell Douglas, the two American companies must integrate operations in dozens of countries around the world. This is just as true for other supposedly "single country" mergers, such as the $27 billion dollar merger of Swiss drug makers Sandoz and Ciba-Geigy.

A number of western government officials are expressing concern over the commercial information for corporate acquisitions being sourced by sovereign governments & state enterprises.

An ad hoc group of SWF Investment Directors and Managers have now established a database called SWF Investments and this database provides shared acquisition information to the SWFs.[14]

The SWF website is restricted and it states: "SWF Investments are a resource which has been established by a number of sovereign wealth funds and state enterprises to produce acquisition and investment databases and forecasting tools for potential acquisition targets. Subscription to SWF Investments is by invitation only, and is restricted to government organizations or state enterprises."

The database seems to be initially concentrating on London Stock Exchange listed companies; however it is believed that the database will in a matter of weeks be extended to include all the companies listed on the stock exchanges of most of the developed countries.

Western government are now in a difficult position, as public opinion and the trades unions prefer the protection and domestic ownership of national companies, however the reality of the present economic situation suggests that an injection of capital into many of the target company may in fact save those companies from bankruptcy.

2.8 TYPES OF ACQUISITION

Reverse takeover: -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.

a. Reverse takeover occurs when the target firm is larger than the bidding firm. In the course of acquisitions, the bidder may purchase the share or the assets of the target company.

b. In the former case, the companies cooperate in negotiations; in the latter case, the takeover target is unwilling to be bought or the target's board has no prior knowledge of the offer.

Reverse merger: - A deal that enables a private company to get publicly listed in a short time period.

a. 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.
b. Achieving acquisition success has proven to be very difficult, while various studies have showed that 50% of acquisitions were unsuccessful. The acquisition process is very complex, with many dimensions influencing its outcome.

2.9 TAKEOVER

A 'takeover' is acquisition and both the terms are used interchangeably. Takeover differs from merger in approach to business combinations i.e. the process of takeover, transaction involved in takeover, determination of share exchange or cash price and the fulfillment of goals of combination all are different in takeovers than in mergers. For example, process of takeover is unilateral and the offeror company decides about the maximum price. Time taken in completion of transaction is less in takeover than in mergers, top management of the offeree company being more co-operative

There are different types of takeovers: -

1. Friendly takeovers
2. Hostile takeovers
3. Reverse takeovers

1. Friendly Takeovers

Before a bidder makes an offer for another company, it usually first informs that company's board of directors. If the board feels that accepting the offer serves shareholders better than rejecting it, it recommends the offer be accepted by the shareholders.

In a private company, because the shareholders and the board are usually the same people or closely connected with one another, private acquisitions are usually friendly. If the shareholders agree to sell the company, then the board is usually of the same mind or sufficiently under the orders of the shareholders to cooperate with the bidder. This point is nonrelevant to the UK concept of takeovers, which always involve the acquisition of a public company.

2. Hostile Takeovers

A hostile takeover allows a suitor to bypass 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. Tender offers in the USA are regulated with the Williams Act.

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.

3. 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, 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

Tracing back to history, merger and acquisitions have evolved in five stages and each of these are discussed here. As seen from past experience mergers and acquisitions are triggered by economic factors. The macroeconomic environment, which includes the growth in GDP, interest rates and monetary policies play a key role in designing the process of mergers or acquisitions between companies or organizations.

First Wave Mergers

The first wave mergers commenced from 1897 to 1904. During this phase merger occurred between companies, which enjoyed monopoly over their lines of production like railroads, electricity etc. The first wave mergers that occurred during the aforesaid time period were mostly horizontal mergers that took place between heavy manufacturing industries.

Majority of the mergers that were conceived during the 1st phase ended in failure since they could not achieve the desired efficiency. The failure was fueled by the slowdown of the economy in 1903 followed by the stock market crash of 1904. The legal framework was not supportive either. The Supreme Court passed the mandate that the anticompetitive mergers could be halted using the Sherman Act.

Second Wave Mergers

The second wave mergers that took place from 1916 to 1929 focused on the mergers between oligopolies, rather than monopolies as in the previous phase. The economic boom that followed the post-World War I gave rise to these mergers. Technological developments like the development of railroads and transportation by motor vehicles provided the necessary infrastructure for such mergers or acquisitions to take place.

The government policy encouraged firms to work in unison. This policy was implemented in the 1920s. The 2nd wave mergers that took place were mainly horizontal or conglomerate in nature. Te industries that went for merger during this phase were producers of primary metals, food products, petroleum products, transportation equipment and chemicals. The investments banks played a pivotal role in facilitating the mergers and acquisitions.

The 2nd wave mergers ended with the stock market crash in 1929 and the great depression. The tax relief that was provided inspired mergers in the 1940s.

Third Wave Mergers

The mergers that took place during this period (1965-69) were mainly conglomerate mergers. Mergers were inspired by high stock prices, interest rates and strict enforcement of antitrust laws.

The bidder firms in the 3rd wave merger were smaller than the Target Firm. Mergers were financed from equities; the investment banks no longer played an important role.

The 3rd wave merger ended with the plan of the Attorney General to split conglomerates in 1968. It was also due to the poor performance of the conglomerates. Some mergers in the 1970s have set precedence.

The most prominent ones were the INCO-ESB merger; United Technologies and OTIS Elevator Merger are the merger between Colt Industries and Garlock Industries.

Fourth Wave Merger

The 4th wave merger that started from 1981 and ended by 1989 was characterized by acquisition targets that wren much larger in size as compared to the 3rd wave merger. Mergers took place between the oil and gas industries, pharmaceutical industries, banking and airline industries. Foreign takeovers became common with most of them being hostile takeovers. The 4th Wave mergers ended with anti-takeover laws, Financial Institutions Reform and the Gulf War.

Fifth Wave Merger

The 5th Wave Merger (1992-2000) was inspired by globalization, stock market boom and deregulation. The 5th Wave Merger took place mainly in the banking and telecommunications industries. They were mostly equity financed rather than debt financed. The mergers were driven long term rather than short term profit motives. The 5th Wave Merger ended with the burst in the stock market bubble. Hence, we may conclude that the evolution of mergers and acquisitions has been long drawn. Many economic factors have contributed its development.

CHAPTER 3

INTERNATIONAL LAWS GOVERNING MERGER AND AMALGAMATION

3.1 GENERAL OVERVIEW

A General overview of laws governing mergers and amalgamations in advance European countries, U.K. and U.S.A. is discussed here under:

3.1.1 Legislative Position in European Countries And United Kingdom

Amalgamation and Merger are very common in U.K. and Europe and is one of the important means of corporate growth. Laws have been enacted in these countries to control and regulate merger and amalgamation. In India laws have been borrowed from the British period for historical reasons and linkages. Provisions made in Indian Companies Act, 1956 regarding mergers and amalgamations are based on U.K.'s Companies Act, 1948 and Amendment Act, 1985. However, in the case of Hind Overseas Pvt Ltd[16]. the Supreme Court rightly observed "that although the Indian Companies Act is modelled on the English Companies Act, the Indian Law is developing on its own lines. Our law is also making significant progress of its own as and when necessary".

However, mergers and amalgamations are so frequent in U.K. that mere provisions under the Companies Act do not help in checking the malpractices which enroots in the business enterprises and prove detrimental to common public interest. In view of this, in U.K. 'City Code' was evolved to discipline the corporate enterprises which go in voluntarily or per force into business combinations

In addition to this, provisions have been made in other enactments like monopolies & Restrictive Trade Practices Act, 1948, Prevention of Fraud (Investment) Act, 1956, Fair Trading Act, 1973, Financial Services Act 1986, etc. to ensure that mergers and amalgamations do not lead to negation of public interest.

In UK, amalgamations and mergers are controlled under the provisions of Fair-Trading Act, 1973 to watch public interest. The Act vests powers in the Government (Secretary of State) to decide on recommendation or reference from Director General of Fair Trading if any particular case of mergers is to be referred to Monopolies and Mergers Commission for investigation and report. The Director General refers only those cases which are likely to have a significant effect on competition in the UK

or in substantial part of UK. Fees are payable to the office of Fair- Trading in respect of Mergers which qualify for investigations. Recommendations of the Monopolies and Mergers commission are important but not necessarily to be followed by the Government. It is the discretion of the Government either to allow merger or not keeping in view of the public interest and to put conditions in relation thereto. Besides, when a merger arises under the Financial Services Act, 1986 in different circumstances it qualifies for investigation by the Monopolies & Mergers Commission under the Act. Such types of mergers are known as "qualifying mergers" which come into existence through schemes of arrangement. The commission takes cognizance for investigation under two conditions i.e., when the gross value of the assets exceeds 30 million pound known as the "Assets Test or as a result of merger the market share of 25% or more for the supply of goods or services of a particular description is created or enhanced in the United Kingdom or in a substantial part of UK. This is known as "market share" test.

Again, European community also controls the important aspects of merger. European Communities Act, 1972 empowers the organization to issue directives to member nations from time to time to maintain uniformity in rules and regulations, accounting procedures in the case of merger and amalgamations.

European Communities Merger Control is exercised by invoking provisions of the European Community Merger Regulation. Notice is required to European Community Commission in those cases which are "concentrations"[17] with a 'Community Dimension'.

This notification is to be made on a prescribed form within one week of the earliest announcement of a pubic bid or acquisition of controlling interest or the execution of the binding agreement. If merger is accomplished without following European Community Merger Regulations, substantial fines and or an order to divest all or part of undertaking acquired may be imposed under the said Regulations.

The key test applied under the European Community Merger Regulation is one of compatibility with the common market. Mergers which create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the common market or a substantial part of it are incompatible with the common market and are therefore to be prohibited.

No member State may apply its national legislation on competition to any concentration that has a community dimension, unless the Commission has referred the appraisal of the concentration to the

competent authority of any Member State with a view to the application of that State's national competition law.

Generally, Companies Act in all major nations where mergers and amalgamations are usual business phenomenon, do contain provisions for regulating the mergers and amalgamations. Besides United Kingdom having merger provisions in the Companies Act, 1948 as mentioned above, in Australia, there is Companies Act, 1961 and South African Companies Act, etc. which provide a complete coverage to the mergers and amalgamations.

3.1.2 Legislative Position in United States of America

Mergers and amalgamations in America have been much more active than other countries in the world because of various reasons like lure for free economy and unrestricted economic system. Despite the free economy, the protection of the interest of the common investors has always been given top priority in America with the result that laws have been framed to regulate such activities of the business enterprises which smack possibilities of defrauding the innocent investors who put in their money in the corporate sector.

The major American anti-trust laws have an impact upon mergers and amalgamations and are contained in the following statutes namely. The Sherman Act, 1890 which prohibits any restraint of trade or attempt to monopolies trade; and The Clayton Act of 1914 which prohibits acquisition resulting into lessening competition or tending to create a monopoly. The basic stress of laws in America is for unrestrained interaction of competitive forces which usually results in the best allocation of economic resources, lowering of prices and production of high-quality goods.

Har-Scott-Rodino Anti-Trust Improvements Act of 1976 brought improvement on Clayton Act 1914 to lighten anti-trust laws. Security Exchange Act, 1934 deals with insider trading under rule 10(b)-5 under the said Act imposing upon directors and the insiders an obligation to disclose material non-public information in connection with the purchase and sale of a company's shares or to refrain from trading. The definition includes 'Tippees" which means person having information from insiders.

The above enactments have been amended from time to time to keep pace with the changing times. Particularly, William Act, 1968 requires the companies negotiating merger to meet the prescribed requirements of transparency and disclosures in the interest of shareholders and investors covering the areas like - identity of the acquirer and the sources of funds, the plan and programmes which acquirer wishes to implement after merger for the benefit of the acquiree company and its

shareholders, making disclosures about shareholdings at stock exchanges.

3.2 LAWS GOVERNING AMALGAMATION AND MERGER: INDIAN PERSPECTIVE

Indian economic system, so far, has been flavored to regulated economy to meet the planned objectives of socialist pattern of economic development. As such, mergers and amalgamations of Companies have been viewed from the angle of antimonopoly and lessening the concentration of economic power in few hands. The Government, as a part of public policy, had come out with restrictions on the private sector corporate enterprises with a view to ensure regulation or control on their growth and to channelize the growth into those directions where maximum public good could be achieved. It is only very recently in the beginning of 1990s that the Government has started taking some steps to liberalize the economy from the restrictions particularly relaxing such restrictions inbuilt in the legal system.

3.2.1 Statutory framework of Merger and Amalgamation: Companies Act, 1956

The Companies Act, 1956 has provided statutory framework for amalgamation of Companies in India. The statutory provisions relating to Merger and amalgamations are provided under Sections 390 to 396A of the Companies Act, 1956.[2]

Section 390 of the Companies Act, 1956 interprets the expressions “company”, “arrangement” and explains unsecured creditors, as used under Sections 391 and 393, Section 391 lays down in detail the power to make compromise or arrangements with creditors and members. Under this section, a company can enter into a compromise or arrangement with creditors or its members, or any class thereof without going into liquidation. Section 392 lays down the power of the High Court while Section 393 specifies the information as to compromises or arrangements that is to be sent with every notice calling the meetings of members and creditors. The provisions for facilitating reconstruction and amalgamation of companies are contained in Section 394. Section 395 prescribes the power and

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[2] The Companies (Second Amendment) Act, 2002 has transferred to the National Company Law Tribunal the powers vested in the Court under Sections 391 to 396 of the Companies Act, 1956. However, the Amendment Act has not become effective as yet. Accordingly, relevant references to the “High Court or Court" will stand replaced with “Tribunal" after the relevant provisions of the Companies (Second Amendment) Act, 2002 are enforced. Likewise, all references to the Company (Court) Rules, 1959 will stand replaced by the rules or regulations that will be framed to enforce compromises and arrangements.

duty of the transferee company to acquire shares of shareholders dissenting from scheme or contract approved by majority. Powers of Central Government to provide for amalgamation of companies in national interest is laid down under Section 396. Section 396A specifies provisions for preservation of books and papers of amalgamated company.

3.2.2 Power to make compromise or arrangement with Creditors and members Section 391 provides in details power to make compromise or arrangements with its creditors and members. According to this section, a company can enter into a compromise or arrangement with its creditors or its members, or any class thereof

When a company proposes a compromise or arrangement between it and its creditors or between it and its members or with any class of the creditors or any class of members, the company or the creditor or member may make an application to the court. On such an application the court may order a meeting of the creditors or members or any class of them as the case may be and such meeting shall be called, held and conducted in such manner as the court may direct. In the case of a company which is being wound up, any such application should be made by the liquidator. The key words and expressions under sub-section are 'creditors', 'court', 'class of creditors or members', 'a company which is being wound up', 'liquidator1. When a company is ordered to be wound up, the liquidator is appointed and once winding up commences liquidator takes charge of the company in all respects and therefore it is he who could file any application of any compromise or arrangement in the case of a company which is being wound up. A company which is being wound up would mean a company in respect of which the court has passed the winding up order.

When the court directs the convening[3], holding and conducting of a meeting of creditors or members or a class of them, a particular majority of the creditors or members or a class of them should agree to the scheme of compromise or arrangement then the majority required is the majority in number representing three-fourths in value of the creditors or members or a class of them, as the case may be, present and voting in the meeting so convened either in person, or by proxy. After the said meeting agrees with such majority, if the scheme is sanctioned, by the court, it shall be binding upon the creditors or members or a class of them, as the case may be. Again, as per the proviso under Sub-section (2) to Sec. 391 no order sanctioning any compromise or arrangement shall be made by the

[3] The Companies Act, 1956, S.391 (2).

court unless it is satisfied that the applicant has made sufficient disclosure about the following particulars. All material facts relating to the company; Latest financial position of the company; Latest auditors report on the accounts of the company; Information about pendency of any investigation proceeding in relation to the company under Sections 235 to 251.

The order made by the court under Sub-section (2) should be filed with the Registrar of Companies. If the order is not filed with the Registrar, it will not have any effect. The requirement under this section is limited to filling of the order of the court and it does not specify the need for the Registrar to register it. It is necessary to annex a copy of every such order to every copy of the Memorandum of company issued after the filling of the certified copy of the order. In the case of a company not having a memorandum the order aforesaid shall be annexed to every copy of the instrument constituting or defining the constitution of the[4] company. If there is any default in complying with Sub-section (4) invites the penalty prescribe din this sub-section. As per the penal clause contained in this sub-section, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 100/- for each copy of the Memorandum or other instrument in respect of which the order of the court has not been annexed. The penal clause under this sub-section is confined to any default under Sub-section (4). The section is silent in respect of contravention of any other statutory requirement. This does not mean contravention of other requirements can take place. It is necessary to note that if the requirements under Sub-sections

(1) to (3) are not complied with or could not be obtained, the scheme itself will not be effective. Therefore, these requirements are very important and if there is any omission, default or deficiency, it would prove fatal to the scheme of compromise or arrangement. The court has powers to stay the commencement of or continuation of any suit or proceeding against the company on such terms as it thinks fit until the application is finally disposed of.

It is well settled that under section 391 the court is invested with very wide powers to approve or sanction any scheme of amalgamation, restructuring, compromise and reconstruction. It has been settled in several classes that section 391 is a complete code and the court has been given wide powers to frame a scheme for the revival of a company. Thus, section 391 provides a mechanism whereby a scheme of reconstruction, reorganization, amalgamation, compromise and arrangement may be

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[4] Ibid,S.391 (3)

carried through.

3.2.3 Enforcement and Supervision:

Powers of the Court As per section 392 of the Companies Act, 1956 the court has the power to supervise the carrying out of the scheme. The court may give such directions or make such modifications to the scheme for the purpose of proper working of the scheme. The court has the power to order winding up of the company if it thinks that the scheme sanctioned cannot work satisfactorily.[5] Section 392 has stressed upon the role of court in unmistakable terms. The courts have got power to supervise modify and also pass winding up orders as and when the situation arises.

Information to Creditors and Members about Compromises or Arrangements Section 393 provides that every notice of any meeting called as per orders of court under Section 391, should include an explanatory statement The statement should set out the terms of compromise or arrangement and all material interests of the directors, managing director or manager of the company and effect of such interest on the scheme. It can also be given by way of an advertisement containing the above-mentioned particulars. Such disclosure shall also be made, in the case of a scheme affecting debenture holders and about the interest of the debenture trustees.[28] If the notice states that creditors or members can have copies of the scheme from the company, the company shall provide copies of the scheme of compromise or arrangement, to the creditor or member who applies for the same. In case of default in complying with the requirements of Section 393, the default is a punishable offence with fine which may extend to fifty thousand rupees. The liquidator of the company and any trustee of a deed for securing the issue of debentures of the company shall be deemed to be an officer of the company. Again, a person shall not be punishable if he shows that the default was due to refusal of any other person being a director, managing director, manager or trustee for debenture holders, to supply the necessary particulars as to his material interest. Every director, managing director, manager or as the case may be, the debenture trustees, shall give all necessary information to the company failing which they shall be liable for the penal consequences with fine which may extend to five thousand rupees.

This section formulates the disclosure norms for the purpose of effecting the compromise or

[5] Ibid, S.391 (4), Ibid, S.391 (5), Ibid, S.391 (6), Ibid, S.392 (1), Ibid, S.392 (2)

arrangement. From the various judicial pronouncements, it is observed that, it is only the 'effect1 that needs to be stated and not the details or particulars of the consequences. However, it has been made clear by the court that unless the statutory provisions as stated in the section are complied with, the scheme will not be sanctioned.

3.2.4 Amalgamation and Reconstruction of Companies

Section 394 of the Companies Act, 1956 stipulates that there is reference to reconstruction of any Company or Companies or amalgamation of any two or more Companies.

Where the scheme[6] involves reconstruction of any company or companies or amalgamation of any two or more companies and vesting of the whole or substantially the whole of the properties or liabilities of any company concerned in the scheme (Transferor Company) to another company (Transferee company), the court may make provision for the following matters also:

(a) Transfer to the Transferee Company of the whole or any part of the undertaking, property or liabilities of any transferor company;

(b) The allotment or appropriation by the Transferee company of any shares, debentures to any person under the scheme.

(c) Continuation of proceedings by or against the Transferee Company of any legal matters pending by or against any Transferor Company.

(d) The dissolution, without winding up, of any Transferor Company.

(e) Provision to be made for any person who does not agree to the scheme.

(f) Such incidental, consequential and supplemental orders passed by the court as it may think fit so that the reconstruction or amalgamation could be fully and effectively carried out.

As per the proviso under this sub-section, it is necessary to have the report from the Registrar of companies in case the scheme involves a company that is being wound up and the report of the liquidator, in case the scheme involves the dissolution of a company. These reports are mandatory in order to ensure that the affairs of the company in question have not been conducted in a manner prejudicial to the interests of its members or to public interest. Again, the order of the Court shall provide for the vesting of the properties and liabilities of the transferor company to the transferee

[6] Ibid, S.394 (1)

company.[7]

The time limit for filling the order of the Court for registration by the Registrar is 30 days after the making of the order.[8] The expression 'property'[9] has been defined to include property, rights and powers of every description and the expression ‘liabilities’ include duties of every description. Transferee Company[10] does not include any company other than a company within the meaning of this Act but Transferor company’ includes anybody corporate, whether a company within the meaning of this Act or not. Thus, the transferee company in a scheme of merger or amalgamation has to be necessarily a company within the meaning of the Act. It is well settled that this section facilitates reconstruction[11] and amalgamation. The court may make provisions for the transfer of the whole or any part of the undertaking, property or liability of any transferor company to the transferee company. Under this section, an order transferring property or liabilities is passed, then by virtue of the order, the property shall be transferred to and vest in and the liabilities shall be transferred to and become the liabilities of the transferee company. This section further provides that the court can also, in appropriate case, pass an order freeing the property transferred from any charge by specifying the same in that order and if so done, the said charge will cease to have effect.

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[7] Ibid, S.394 (2)

[8] Ibid, S.394 (2)

[9] Ibid, S.394 (4)(a)

[10] Ibid, S.394 (4)(b)

[11] The term ‘reconstruction’, inter alia, indicates the process which involves (I) the transfer of undertaking of an existing company to another company, usually incorporated for the purpose. The old company ceases to exist. However, all the assets might not pass to the new company; (ii) the carrying on of substantially the same business by the same persons; (iii) the rights of the shareholders in the old company are satisfied by their being allotted shares in the new company. A reconstruction Is made for any of the following purpose : (a) to extend the operations of the company If the shares are fully paid-up and it is desired to raise further capital, the shareholders in the old company may be issued only partly paid shares in the new company so that by calling up the uncalled amount, the undertaking of an existing company to another company, usually incorporated for the purpose. The old company ceases to exist. However, all the assets might not pass to the new company; (ii) the carrying on of substantially the same business by the same persons; (iii) the rights of the shareholders in the old company are satisfied by their being allotted shares in the new company. A reconstruction Is made for any of the following purpose : (a) to extend the operations of the company If the shares are fully paid-up and it is desired to raise further capital, the shareholders in the old company may be issued only partly paid shares in the new company so that by calling up the uncalled amount, the company would have the necessary funds for carrying on its business. Also, If the company wants to do business which is totally unrelated to its objects, it may resort to reconstruction. The objects clause of the new company may include the business which It wants to pursue, (b) For purposes of reorganization It implies alteration or modification of the rights of shareholders or creditors or both.

3.2.5 Complete Code on Amalgamation: Sections 391 to 394

Section 391 to 394 of the Companies Act 1956 are a complete Code, which is intended to be a single window clearance system. The salient features of sections 391 and 394 briefly are:

1. There should be a scheme of amalgamation or compromise or arrangement.
2. An application should be made to the Court for direction to hold meetings of shareholders and or creditors
3. Court may order a meeting of shareholders and creditors. The Court may dispense with the meetings as well
4. Meetings should be held as per the Court's order. Scheme must be approved by three-fourth majority in value of creditors, class of creditors and members, class of members.
5. Another application should be made to Court sanctioning the scheme.
6. An approved scheme duly sanctioned by the Court is binding on all the shareholders, creditors and company.
7. The Court's order takes effect when the same is filed with the Registrar of Companies.
8. Copy of every order should be annexed with the Memorandum of Association of the company.
9. Court may stay, commencement or continuation of any suit or proceedings against the company after the application is moved in the Court.
10. The Court's order is appealable in the superior Court.

Very importantly, in the case of Sadanand S. Varde[12] Bombay High Court held that "the fasciculus of Sections 391 to 394 of the Companies Act, 1956 constitute a complete code on the subject of amalgamation. Section 394(1) lays down that where an application has been made to the court under Section 391 for sanctioning of a compromise or arrangement proposed and it is shown to the court that: (a) the said compromise or arrangement has been proposed for the purpose of reconstruction or amalgamation; and (b) under the scheme whole or any part of undertaking, property or liabilities is to be transferred to another company". Accordingly, merger can also be affected when the High Court may sanction a scheme vide Sec. 394 when a scheme of amalgamation proposed by two or more companies after it has been approved by a meeting of the members of the company convened

[12] Sadanand S. Varde v. State of Maharashtra (2001) 30 SCL 268 (Bom.)

under the orders of the court with majority in number of shareholders holding more than 75 percent of the shares who vote at the meeting, approve the scheme of amalgamation, and the companies make a petition to the High Court for approving the Scheme. Once the Court sanctions the scheme, it is binding on all the members of the respective companies.

Again, the court is supposed to give notice of every scheme under section 391 or 394 to the Central Government and consider representations, if any by the said Government.[13]Therefore it can be said that merger or amalgamation under a scheme of arrangement as provided under Sections 391 -394 of the Act is the most convenient and most common method of a complete merger or amalgamation between the companies. There is active involvement of the Court and an amalgamation is complete only after the Court sanctions it under Section 394(2) and takes effect when such order of court is filed with the Registrar of Companies. In fact, Sections 391 to 394 of the Act read with Companies (Court) Rules, 1959 serve as a complete code in themselves in respect of provisions and procedures relating to sponsoring of the scheme the approval thereof by the creditors and members, and the sanction thereof by the Court.

3.2.6 Acquisition of shares involving minority interest

When certain shareholders dissent then section 395[14] contains provisions for the compulsory acquisition by the transferee company of shares of the dissenting minority. The shares may be acquired on the same terms on which the shares of the approving shareholders are to be transferred to it. This will prevent the minority shareholders from demanding too high a price for their shares. Now, in terms of section 395 where the transferee company has offered to acquire the shares or any class of shares of the transferor company, the scheme or contract embodying such offer has to be approved by the shareholders concerned within four months. The approval must be given by the holders of not less than 9/ 10ths in value of the shares whose transfer is involved. In computing 9/10th value of shares, the shares already held by the transferee company or its nominee or subsidiary are

[13] The Companies Act, 1956, S.394A.

[14] Under Section 395 of the Companies Act, 1956, the undertaking of one company can be taken over by another company by the purchase of shares. This section obviates the need to obtain the High Court's sanction, while purchasing shares, the company which acquires shares, should comply with the requirements of SEBI (substantial Acquisition of shares and Takeovers) Regulation, 1997 and S.372A of the Companies Act 1956. This section also provides the procedure for acquiring the shares of dissenting members.

excluded and in case the offer is approved, the transferee company may, at any time within two months of the expiry of the said four months, give a notice to the dissenting shareholders that it desires to acquire their shares. The transferee company is entitled and bound to acquire the shares of dissenting shareholders on the same terms on which the shares of approving shareholders were approved unless on the application of the dissenting shareholders within one month of such notice, the Court orders otherwise. If the transferee company already holds in the transferor company shares of the class whose transfer is involved, to a value more than 1/10th of the total value of all shares of that class in that company, then the above provisions will not apply and the transferee company cannot acquire the shares of the dissenting members. However, it is entitled to still acquire the shares if:

(a) it offers the same-terms to all the shareholders of the same class, and

(b) the shareholders who approve of the scheme, besides holding not less than 9/10 th in value of the shares other than those already held by the transferee company by itself or through nominees, are also not less than 3/4ths in number of the holders of those shares. Where the transferee company or its nominee or subsidiary already holds in the transferor company at least 9/10th in value of shares of the class agreed to be transferred in pursuance of the scheme, then the transferee company must give notice of the fact to the remaining dissenting shareholders of the transferor company within one month of the date of transfer already made. On receipt of such notice, the dissenting shareholders may, within three months, require the transferee company to acquire their shares. Then the transferee company will be entitled and bound to acquire such shares on the same terms as that of the approving shareholders or on such other terms as may be agreed or as ordered by the Court, on the application of the transferee company or the shareholder. Where notice has been given by the transferee company to the dissenting shareholders expressing its desire to acquire their shares and the Court has not made an order on the application of the dissenting shareholders modifying the scheme of transfer, then the transferee company must send a copy of the notice to the transferor company on the expiry of one month from the date of the notice, together with an instrument of transfer executed by the transferee company itself through any of its persons and the deal also completed by the transferee company in the instrument. This time period of one month shall also run in a case where a Court reference was made by the dissenting shareholder and the Court disposed of the petition only after the notice was given, then from the date the petition was disposed of. The transferee company must also pay or transfer to the transferor company the amount or consideration representing the price of the shares which it is entitled to acquire under the section 395. Thereupon, the transferor company shall register

the transferee company as the holder of those shares and inform the dissenting shareholder of the fact within one month of registration. The transferor company will also deposit the amount so received in a separate bank account to be held in trust for the holders of shares in respect of which such amount has been received.

Very importantly, it can be felt that if the dissenting shareholders do not petition to the court, there is no requirement in section 395 to follow court procedure. Even when dissenting shareholders apply to the Court, the Court's intervention is limited to passing an order on the application. Occasion may also arise for the transferee company to approach the Court for the limited purpose of settling the matter with dissenting shareholders.

Now, if Section 394 is compared with Section 395 then it is envisaged that under section 394 the transfer of undertaking or property is a part of compromise or arrangement agreed to by a majority representing three-fourth in value of the shareholders or creditors at a meeting ordered by the court under section 391. The scheme of compromise or arrangement has to be sanctioned by the Court under Section 391(2). Once it has been sanctioned the scheme becomes binding on all the shareholders or creditors and the dissenting or minority members have no remedy against the sanctioned scheme. But under section 395 no compromise or arrangement is involved, in spite of the use of the expression "a scheme or contract"[15] and "in pursuance of such scheme or contract".[42] Neither meeting nor sanction as under section 391 is required. But the company proposing to transfer its shares has to obtain approval of not less than nine-tenths in value of the shares.

Again, constitutional validity of section 395 was challenged in case of Viswanathan[16] whereby the provisions of sec. 153B of 1913 Act (Section 395 of 1956 Act) was assailed as ultra vires of the constitution. The contention was that it gives transferee company right to acquire the shares held by the dissenting members of the transferee company. The Court held that the dissenting member is given the right to apply to the court on receipt of notice from their transferee company and if on examining the scheme the court feels that it is a wicked thing to do, it will naturally deny the right to the transferee company conferred under this section. The court has the power to permit or deny the transferee company the right to be exercised depending on the nature of the transaction whether oppressive, unjust, unfair on unconscionable, whether the consent of majority is obtained fairly or by unjust means and Court has held that the power of acquisition of shares of the dissentient minority

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[15] The Companies Act, 1956, S.395(1)
[16] Ibid, S.395(2).

shareholders is not ultra vires the constitution of India.

Finally, disclosure of information in relation to every offer or a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company[44] which is as follows:

- Every such offer or every circular containing such offer, or every recommendation by the directors of the transferor company to its shareholders to accept such offer, must be accompanied by such information as may be prescribed by the Central Government.
- Every such offer must contain a statement by or on behalf of the transferee company disclosing the steps it has taken to ensure that necessary cash will be available.
- Every circular containing or recommending acceptance of such offer must be presented to the Registrar for registration and no such circular can be issued until it is so registered.
- The Registrar may refuse to register any such circular which does not contain the prescribed information as per clause (a) above, or which sets out such information in a manner likely to give a false impression.
- An appeal may be made to the Court against an order of the Registrar refusing to register such circular.

Any person responsible for issue of a circular containing ah offer involving transfer of shares under a scheme or contract without getting the same registered shall be punishable with fine up to rupees five thousand.

3.3 INDIAN LEGAL ISSUES INVOLVED IN MERGER & ACQUISITIONS SEBI

3.3.1 Takeover Regulations/Company Law in M&A:[17]

Mergers are primarily supervised by the High Court(s) and the Ministry of Company Affairs. The SEBI regulates takeovers of companies that have shares listed on any stock exchange in India. The main corporate and securities law provisions governing mergers and takeovers are:

- Sections 108A to 108I of CA56, which place restrictions on the transfer and acquisition of shares where the shareholdings of the bidder or transformer would either:
- Result in a dominant undertaking; or

[17] http://www.indialawjournal.org/archives/volume1/issue_1/m_a_regulations.html

- In case of a pre-existing dominant undertaking, result in an increase in the production, supply, distribution or control of goods and services by it.
- Section 390 to 394 of CA56, which govern the schemes of arrangement between companies and their respective shareholders and creditors, under the supervision of the relevant High Court.

- The Takeover Code, which sets out procedures governing any attempted takeover of a company that has its shares listed on one or more recognized stock exchange(s) in India. Regulation 10, 11, and 12 of the Takeover Code, which deal with public offers, do not apply to a scheme framed under the Sick Industrial Companies (Special Provisions) Act, 1985 ("**SICA**"), or to an arrangement or reconstruction under any Indian or foreign law

  The Takeover Code, however, does not apply to the following acquisitions:

  - Allotment of shares made in public issue or in right issue;
  - Allotment of shares to underwriters in pursuance of underwriting agreement;
  - Inter-se transfer between group, relative, foreign collaborators and Indian promoters who are shareholders, acquirer and persons acting in concert with him;
  - Acquisition of shares in the ordinary course of business by a registered stockbroker on behalf of his client, market maker, public financial institutions in their own account, banks and financial institutions as pledgees, international financial institutions, and merchant banker or promoter of the target company under a scheme of safety net;
  - Exchange of shares received in a public offer made under the Takeover Code;
  - Transmission of shares in succession or inheritance;
  - Acquisition of shares by government companies and statutory corporations. However, acquisition in a listed public sector undertaking, through the process of competitive bidding process of the Central Government is not exempted;
  - Transfer of shares by state level financial institutions to co-promoters under an agreement;
  - Transfer of shares venture capital funds or registered venture capital investors to a venture capital undertaking or to its promoters pursuant to an agreement;
  - Acquisition of shares in pursuance of a scheme of rehabilitation of a sick company, amalgamation, merger or demerger;
  - Acquisition of shares of an unlisted company. However, if such acquisition results in

acquisition or change of control in a listed company, the exemption will not be available;

- Acquisition of global depository receipts and American depository receipts so long as they are not converted into shares carrying voting rights.
- Section 17, 18 and 19A of the SICA, which regulate schemes formulated by the Board for Industrial and Financial Reconstruction, a statutory body established under the SICA, for the reconstruction and amalgamation of "sick" companies (that is, any company which, at the end of any financial year, has accumulated losses equal to or exceeding the entire net worth). The Sick Industrial Companies (Special Provisions) Repeal Act 2003 ("**SICA Repeal**"), which repeals the SICA, has been enacted but has not yet come into force. Similarly, while the Companies (Second Amendment) Act, 2002 has introduced Chapter VIA in the CA56, which makes substantial amendments to the regime governing sick companies, these provisions are also yet to come into effect (there is no indication as to when these provisions are likely to come into force). As a result, SICA continues to be valid and binding.

There are also rules governing the acquisition of shares in an Indian company by a non- resident.

3.3.2 Due Diligence in M&As:

The purpose of the due diligence exercise is to identify any issues that may affect the bid including, but not limited to, the price of the bid. Generally, the bidder (in case of recommended as well as hostile bids) will want to determine the following about the target company:

- Its capital structure including shareholding pattern.
- The composition of its board of directors.
- Any shareholders' agreement or restrictions on the shares, for example, on voting rights or the right to transfer the shares.
- Its level of indebtedness.
- Whether any of its assets have been offered as security for raising any debt.
- Any significant contracts executed by it.
- The status of any statutory approvals, consents or filings with statutory authorities.
- Employee details.
- Significant litigation, show cause notices and so on relating to the target and/or its areas of business.

- Any other liability, existing or potential.

3.3.3 Public Domain

Information on a target that is in the public domain and is accessible to the bidder includes its:

- Constitutional documents;
- Annual reports and annual returns filed with statutory authorities, giving information on shareholdings, directors and so on.
- Quarterly and half-yearly reports, in the case of listed companies (in accordance with the standard listing agreement prescribed by the SEBI).

A listed company must inform the stock exchanges of important decisions taken by its board of directors.

3.3.4 Contractual Issues in M&As

While economic and business reasons may be the factors behind both M&As, contractual and legal formalities involved are rather different. Share sale and purchase/acquisition agreement, asset and business transfer agreements, representations and warranties, indemnity, non- compete and non-solicitation, confidentiality, governing law, post completion matters and indemnities are significant agreements and clauses to effectively execute M&As.

3.3.5 Contents of a Share Purchase Agreement

Condition precedent – The condition precedents incorporated in a share purchase agreement may include obtaining necessary approvals from various governmental regulatory bodies that may be necessary to effectively execute the share purchase agreement and the proper functioning of the target company.

Management and Control – The devising of an appropriate governance structure of the target company is of great importance for effective management, growth and success of the target company. The share purchase agreement should explicitly set out the participation of the acquirer and also the rights, obligations and duties of the management of the target company including that of the board of directors, nominee directors and the chairman.

Intellectual Property Rights – If the merger involves a transfer, assignment or right to use an intellectual property such as trademark, copyright, know-how, etc. the same should be protected in

the share purchase agreement.

Non-Competition/Conflict of Interest – The non-compete clause in a share purchase agreement is incorporated with intent to restrain the contracting party from carrying out any independent activity in competition to that of the target company.

Deadlock Provision – The parties may have similar or dissimilar thinking patterns. Therefore, there has to be a mechanism for resolving any issues on which there is a deadlock between the parties. The chairman may be given a casting vote to avoid such a problem.

Confidential Information – The share purchase agreement can make all the provisions contained in or related to or arising from the share purchase agreement to be confidential in nature

Survival Clause – It may be prudent to provide for certain obligations contained in or related to or arising from the share purchase agreement to survive pursuant to the termination of the share purchase agreement.

3.3.6 Intellectual Property Law and M&As

In case of M&A of companies, all the assets of the transferor company including intellectual property assets such as patents, copyrights, trademarks and designs vest in the transferee.

Where the transferor company owns the intellectual property assets, such assets are transferred to the transferee company under the scheme of arrangement.

Unregistered trademark/copyright is transferable as any other right in a property under the scheme of arrangement framed under section 394 of CA56. In case of registered trademarks/copyrights and patents, the transferee company has to apply to the respective Registry for registering its title pursuant to the order of the High Court sanctioning the scheme. The transmission/transfer of the trademark/copyright rights in the license may be permitted in an instance where the licensor himself assents to such transfer of a license subsequent to a merger.

3.3.7 Exchange Control Issues

The Foreign Direct Investment ("**FDI**") regime in India has progressively liberalized and the Government of India recognizes the key role of FDI in economic development of a country. With very limited exceptions, foreign entities can now invest directly in India, either as wholly owned subsidiaries or as a joint venture. In an international joint venture, any proposed investment by a foreign entity/individual in an existing entity may be brought in either through equity expansion or

by purchase of the existing equity.

Where the transfer of shares is by way of sale under a private arrangement, by a person resident in to a person resident outside India the price of the shares will not be less than the ruling market price in case of shares listed on a stock exchange or the value of the shares calculated as per the guidelines issued by the erstwhile Controller of Capital Issues and certified by a Chartered Accountant. In either of the cases the sale consideration must be remitted into India through normal banking channels. Lastly, to affect the transfer, a declaration in the form FC TRS should be filed with an authorized dealer along with the a consent letter indicating the details of transfer, shareholding pattern of the investee company after the acquisition of shares by a person resident outside India showing equity participation of residents and non-residents, certificate indicating fair value of shares from a chartered accountant or in case of a public listed company copy of the broker's note and an undertaking from the buyer to the effect that he is eligible to acquire shares in accordance with the FDI policy.

3.4 MONOPOLIES AND RESTRICTIVE TRADE PRACTICES ACT, 1969 ("MRTP ACT") AND COMPETITION ACT, 2002 ("CA02")

The MRTP Act aims towards controlling monopolistic, restrictive and unfair trade practices, which curtail competition in trade and industry. Monopolistic trade practice includes a trade practice unreasonably preventing or lessening competition in the production, supply or distribution of any goods or in the supply of any services. Sections 108A to 108I incorporated in CA56 restrict the transfer of shares by body or bodies corporate under the same management holding 10% or more of the subscribed share capital of any company without intimating the Central government of the proposed transfer.

The Competition Commission can investigate any combination, which is a merger or acquisition where any of the following apply:

- The parties jointly have assets exceeding INR 10 billion (about US$ 227 million) or turnover of more than INR 30 billion (about US$682 million) in India, or assets of US$ 500 million (about EUR 413 million) or turnover of more than US$ 1.5 billion (about EUR 1.2 billion) in India or outside India.
- The group to which the company will belong after the acquisitions and the company jointly have assets exceeding INR 40 billion (about US$ 909.6 million) or turnover of more than INR 120 billion (about US$ 2.7 billion) in India, or assets of US$ 2 billion (about EUR 1.7

billion) or turnover of more than INR 120 billion (about US$ 2.7 billion) in India, or assets of US$ 2 billion (about EUR 1.7 billion) or turnover of more than US$ 6 billion (about EUR 5 billion) in India or outside India.

- The bidder already has direct or indirect control over another enterprise engaged in the production, distribution or trading of a similar, identical or substitutable good or service, and the acquired enterprise and this other enterprise jointly have assets exceeding INR 10 billion or turnover of more than INR 30 billion in India, or assets of US$ 500 million or turnover of more than US$ 1.5 billion in India or outside India.
- The enterprise after the merger or acquisition has assets exceeding INR 10 billion or turnover of more than INR 30 billion in India, or assets of US$ 500 million or turnover of more than US$ 1.5 billion in India or outside India.

While investigating the combination, the Competition Commission must examine whether it is likely to cause, or causes, an adverse effect on competition within the relevant market in India. The Competition Commission has 90 days from the date of publication of details of the combination by the parties to pass an order approving, prohibiting or requiring modification of the combination, or to issue further directions. If it does not do this, the combination is deemed approved. There is no obligation to suspend the combination while the investigation is taking place.

3.4.1 Tax Implications in M&As:

Amalgamations and Demergers attract the following taxes: -

- Capital Gains Tax – Under the IT Act, gains arising out of the transfer of capital assets including shares are taxed. However, if the resultant company in the scheme of amalgamation or demerger is an Indian Company, then the company is exempted from paying capital gains tax on the Transfer of Capital Assets.
- Tax on transfer of Share – Transfer of Shares may attract Securities Transaction Tax and Stamp Duty. However, when the shares are in dematerialized form then no Stamp duty is attracted.
- Tax on transfer of Assets/Business – Transfer of property also attracts tax which is generally levied by the states.
- Immovable Property – Transfer of Immovable Property attracts Stamp Duty and Registration fee on the instrument of transfer.

- Movable Property - The transfer of Movable Property attracts VAT which is determined by the State and also Stamp Duty on the Instrument of transfer.
- Transfer of tax Liabilities –Income Tax – The predecessor is liable for all Income Tax payable till the effective date of restructuring. After the date of restructuring, the liability falls on the successor.
- Central Excise Act – Under the Central Excise Act, when a registered person transfers his business to another person, the successor should take a fresh registration and the predecessor should apply for deregistration. In case the predecessor has CENVAT Credit, the same could be transferred.
- Service Tax – As regards service tax, the successor is required to obtain fresh registration and the transferor is required to surrender his registration certificate in case it ceases to provide taxable services. The provisions regarding transferring the CENVAT credit are similar to the Central Excise provisions.
- Value Added Tax – Usually statutes governing levy of VAT specify for an intimation of change of ownership and name to the relevant authority, but these statutes do not provide any specific guidelines with regard to the transfer of tax credit. The obligation of the predecessor and the successor is joint and several.

There is a growing need to bring a change in the present law but a coordinated approach should be taken while bringing amendments in the CA56. The change is required to provide for maximum flexibility and to provide equal opportunities to economic players in the global market. This would also help in bringing Indian law in consonance with the law regarding mergers in other countries.

CHAPTER 4
LAWS REGULATING MERGER

4.1 OTHER SUPPORTING LAWS

Following are the laws that regulate the merger of the company:

4.1.1 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 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 somewhat in an application seeking compromise or arrangement.

3. 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.
4. 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.
5. 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.
6. 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.

4.1.2 The Competition Act ,2002

Following provisions of the Competition Act, 2002 deals with mergers of the company: -

Section 5 of the Competition Act, 2002 deals with "Combinations" which defines combination by reference to assets and turnover

- exclusively 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.

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.

4.1.3 Foreign Exchange Management Act,1999

The foreign exchange laws relating to issuance and allotment of shares to foreign entities are contained in The Foreign Exchange Management (Transfer or Issue of Security by a person residing out of India) Regulation, 2000 issued by RBI vide GSR no. 406(E) dated 3rd May, 2000. These regulations provide general guidelines on issuance of shares or securities by an Indian entity to a person residing outside India or recording in its books any transfer of security from or to such person. RBI has issued detailed guidelines on foreign investment in India vide “Foreign Direct Investment Scheme” contained in Schedule 1 of said regulation.

4.1.4 The Indian Income Tax Act (ITA), 1961

Merger has not been defined under the ITA but has been covered under the term 'amalgamation' as defined in section 2(1B) of the Act. To encourage restructuring, merger and demerger has been given a special treatment in the Income-tax Act since the beginning. The Finance Act, 1999 clarified many issues relating to Business Reorganizations thereby facilitating and making business restructuring tax neutral. As per Finance Minister this has been done to accelerate internal liberalization. Certain provisions applicable to mergers/demergers are as under: Definition of Amalgamation/Merger — Section 2(1B).

Amalgamation means merger of either one or more companies with another company or merger of two or more companies to form one company in such a manner that:

1. All the properties and liabilities of the transferor company/companies become the properties and liabilities of Transferee Company.
2. Shareholders holding not less than 75% of the value of shares in the transferor company (other than shares which are held by, or by a nominee for, the transferee company or its subsidiaries) become shareholders of the transferee company.

The following provisions would be applicable to merger only if the conditions laid down in section

2(1B) relating to merger are fulfilled:

1. Taxability in the hands of Transferee Company — Section 47(vi) & section 47
    a. The transfer of shares by the shareholders of the transferor company in lieu of shares of the transferee company on merger is not regarded as transfer and hence gains arising from the same are not chargeable to tax in the hands of the shareholders of the transferee company. [Section 47(vii)]
    b. In case of merger, cost of acquisition of shares of the transferee company, which were acquired in pursuant to merger will be the cost incurred for acquiring the shares of the transferor company. [Section 49(2)]

4.1.5 Company Bill 2011

The provisions of the Companies Act, 1956, specifically sections 391 to 394, contain an elaborate framework that enable companies to give effect to arrangements and compromises with their shareholders and creditors. The expression "arrangement" has interpreted to include a wide range of transactions, such as mergers, demergers and other forms of corporate restructuring (including debt restructuring). This framework has largely functioned well, and in fact these provisions have been extensively used by the corporate sector in India, much more so than similar provisions contained in statutes in other countries. The judiciary has also clearly laid out the parameters within which such schemes of arrangement may be initiated, approved by shareholders and creditors and then accorded the sanction of the court.

The Companies Bill, 2011 seeks to make a number of changes to this framework that are likely to have an impact on mergers and acquisitions (M&A) transactions involving Indian companies. While some of the proposals are intended to make it easier for companies to implement schemes of arrangement, others impose checks and balance to prevent possible abuse of these provisions by companies. Ernst & Young has a nice comparison of the provisions in the Companies Act and the 2011 Bill on matters relating to mergers and acquisitions.

Mandatory permission by the courts

Any scheme for mergers has to be sanctioned by the courts of the country. The company act provides that the high court of the respective states where the transferor and the transferee companies have

their respective registered offices have the necessary jurisdiction to direct the winding up or regulate the merger of the companies registered in or outside India.

The high courts can also supervise any arrangements or modifications in the arrangements after having sanctioned the scheme of mergers as per the section 392 of the Company Act. Thereafter the courts would issue the necessary sanctions for the scheme of mergers after dealing with the application for the merger if they are convinced that the impending merger is “fair and reasonable”.[55]

The courts also have a certain limit to their powers to exercise their jurisdiction which have essentially evolved from their own rulings. For example, the courts will not allow the merger to come through the intervention of the courts, if the same can be affected through some other provisions of the Companies Act; further, the courts cannot allow for the merger to proceed if there was something that the parties themselves could not agree to; also, if the merger, if allowed, would be in contravention of certain conditions laid down by the law, such a merger also cannot be permitted. The courts have no special jurisdiction with regard to the issuance of
writs to entertain an appeal over a matter that is otherwise “final, conclusive and binding” as per the section 391 of the Company Act.

4.1.6 Intellectual Property Due Diligence in Mergers And Acquisitions

The increased profile, frequency, and value of intellectual property related transactions have elevated the need for all legal and financial professionals and Intellectual Property (IP) owner to have thorough understanding of the assessment and the valuation of these assets, and their role in commercial transaction. A detailed assessment of intellectual property asset is becoming an increasingly integrated part of commercial transaction. Due diligence is the process of investigating a party’s ownership, right to use, and right to stop others from using the IP rights involved in sale or merger ---the nature of transaction and the rights being acquired will determine the extent and focus of the due diligence review. Due Diligence in IP for valuation would help in building strategy, where in: -

a. If Intellectual Property asset is underplayed the plans for maximization would be discussed.
b. If the Trademark has been maximized to the point that it has lost its cachet in the market place, reclaiming may be considered.
c. If mark is undergoing generalization and is becoming generic, reclaiming the mark from

slipping to generic status would need to be considered.

d. Certain events can devalue an Intellectual Property Asset, in the same way a fire can suddenly destroy a piece of real property. These sudden events in respect of IP could be adverse publicity or personal injury arising from a product. An essential part of the due diligence and valuation process accounts for the impact of product and company-related events on assets – management can use risk information revealed in the due diligence.

e. Due diligence could highlight contingent risk which do not always arise from Intellectual Property law itself but may be significantly affected by product liability and contract law and other non-Intellectual Property realms.

Therefore, Intellectual Property due diligence and valuation can be correlated with the overall legal due diligence to provide an accurate conclusion regarding the asset present and future value.

4.2 LEGAL PROCEDURE FOR BRINGING ABOUT MERGER OF COMPANIES

Examination of object clauses:

The MOA of both the companies should be examined to check the power to amalgamate is available. Further, the object clause of the merging company should permit it to carry on the business of the merged company. If such clauses do not exist, necessary approvals of the share holders, board of directors, and company law board are required.

Intimation to stock exchanges:

The stock exchanges where merging and merged companies are listed should be informed about the merger proposal. From time to time, copies of all notices, resolutions, and orders should be mailed to the concerned stock exchanges.

Approval of the draft merger proposal by the respective boards:

The draft merger proposal should be approved by the respective BOD's. The board of each company should pass a resolution authorizing its directors/executives to pursue the matter further.

Application to high courts:

Once the drafts of merger proposal is approved by the respective boards, each company should make an application to the high court of the state where its registered office is situated so that it can convene the meetings of shareholders and creditors for passing the merger proposal.

Dispatch of notice to shareholders and creditors:

In order to convene the meetings of shareholders and creditors, a notice and an explanatory statement of the meeting, as approved by the high court, should be dispatched by each company to its shareholders and creditors so that they get 21 days advance intimation. The notice of the meetings should also be published in two newspapers.

Holding of meetings of shareholders and creditors:

A meeting of shareholders should be held by each company for passing the scheme of mergers at least 75% of shareholders who vote either in person or by proxy must approve the scheme of merger. Same applies to creditors also.

Petition to High Court for confirmation and passing of HC orders:

Once the mergers scheme is passed by the shareholders and creditors, the companies involved in the merger should present a petition to the HC for confirming the scheme of merger. A notice about the same has to be published in 2 newspapers.

Filing the order with the registrar:

Certified true copies of the high court order must be filed with the registrar of companies within the time limit specified by the court.

Transfer of assets and liabilities:

After the final orders have been passed by both the HC's, all the assets and liabilities of the merged company will have to be transferred to the merging company.

Issue of shares and debentures:

The merging company, after fulfilling the provisions of the law, should issue shares and debentures of the merging company. The new shares and debentures so issued will then be listed on the stock exchange.

4.3 WAITING PERIOD IN MERGER

International experience shows that 80-85% of mergers and acquisitions do not raise competitive concerns and are generally approved between 30-60 days. The rest tend to take longer time and, therefore, laws permit sufficient time for looking into complex cases. The International Competition

Network, an association of global competition authorities, had recommended that the straight forward cases should be dealt with within six weeks and complex cases within six months.

The Indian competition law prescribes a maximum of 210 days for determination of combination, which includes mergers, amalgamations, acquisitions etc. This however should not be read as the minimum period of compulsory wait for parties who will notify the Competition Commission. In fact, the law clearly states that the compulsory wait period is either 210 days from the filing of the notice or the order of the Commission, whichever is earlier. In the event the Commission approves a proposed combination on the 30th day, it can take effect on the 31st day. The internal time limits within the overall gap of 210 days are proposed to be built in the regulations that the Commission will be drafting, so that the over whelming proportion of mergers would receive approval within a much shorter period.

The time lines prescribed under the Act and the Regulations do not take cognizance of the compliances to be observed under other statutory provisions like the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ('SEBI Takeover Regulations'). SEBI Takeover Regulations require the acquirer to complete all procedures relating to the public offer including payment of consideration to the shareholders who have accepted the offer, within 90 days from the date of public announcement. Similarly, mergers and amalgamations get completed generally in 3-4 months' time. Failure to make payments to the shareholders in the public offer within the time stipulated in the SEBI Takeover Regulations entails payment of interest by the acquirer at a rate as may be specified by SEBI. [Regulation 22(12) of the SEBI Takeover Regulations] It would therefore be essential that the maximum turnaround time for CCI should be reduced from 210 days to 90 days.

CHAPTER 5

MOTIVE, BENEFIT AND DRAWBACK OF MERGER AND ACQUISITION

5.1 MOTIVES BEHIND MERGER AND ACQUISITION

There are three major motives for the mergers and takeovers: Synergy, Agency, Hubris Synergy motive means that the sum total return/value from the integration of two or more companies should be greater than that from the individual company. Elazar Berkovitch (1993) suggests that the takeovers occur because of economic gains that results by merging the resources of the two firms. They even concluded that total gains from M&A are always positive and thus can say that synergy appears.

The agency motive suggests that takeovers occur because they enhance the acquirer management's welfare at the expense of acquirer shareholders.

Elazar Berkovitch and M. P. Narayanan (1993) suggested three major motives for mergers and acquisitions: synergy, agency and hubris. The synergy motive suggests that the takeovers occur because of economic gains that results by merging the resources of the two firms. The agency motive suggests that takeovers occur because they enhance the acquirer management's welfare at the expense of acquirer shareholders. The hubris hypothesis suggests that managers make mistakes in evaluating target firms, and engaged in acquisitions even when there is no synergy. Khemani (1991) states that there are multiple reasons, motives, economic forces and institutional factors that can be taken together or in isolation, which influence corporate decisions to engage in M&As. It can be assumed that these reasons and motivations have enhanced corporate profitability as the ultimate, long-term objective. It seems reasonable to assume that, even if this is not always the case, the ultimate concern of corporate managers who make acquisitions, regardless of their motives at the outset, is increasing long-term profit. However, this is affected by so many other factors that it can become very difficult to make isolated statistical measurements of the effect of M&A's on profit.[18]

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[18] https://www.ukessays.com/dissertation/examples/finance/the-motive-behind-merger-and-acquisition.php

The "free cash flow" theory developed by Jensen (1988) provides a good example of intermediate objectives that can lead to greater profitability in the long run. This theory assumes that corporate shareholders do not necessarily share the same objectives as the managers. The conflicts between these differing objectives may well intensify when corporations are profitable enough to generate "free cash flow," i.e., profit that cannot be profitably re-invested in the corporations. Under these circumstances, the corporations may decide to make acquisitions in order to use these liquidities. It is therefore higher debt levels that induce managers to take new measures to increase the efficiency of corporate operations. According to Jensen, long-term profit comes from the re-organization and restructuring made necessary by takeovers.

5.2 ADVANTAGES & DISADVANTAGES OF MERGER & ACQUISITION

Mergers and acquisitions (M&A) are two different concepts, however, over the period of time, the distinction has blurred, and now they are often used in exchange for each other. In mergers, two similarly sized companies combine with each other to form a new company. The acquisition, on the other hand, occurs when one company purchases another company and thus becomes the new owner. The process which is generally followed in both these concepts usually starts out with a series of informal discussions between the companies by their representatives, which is followed by formal negotiation, then the issuance of a letter of intent, the process of due diligence, entering into a purchase or merger agreement, and finally, the execution of the deal and the transfer of payment.

The next question which comes into our mind is that why do these companies enter into such transactions.

5.3 PROS OF MERGERS AND ACQUISITIONS

Some of the most common reasons for companies to engage in mergers and acquisitions include-

- To become bigger Most of the companies enter into M&A agreements to increase their size and to eliminate their rivals from the market. In the normal circumstances, it can take many years for a company to double its size, but the same can be achieved much more

rapidly through mergers or acquisitions.[19]

- To eliminate competition M&A deals are usually done so as to allow the acquirer company to eliminate the future competition by gaining a larger market share in its product's market.

However, there is a con attached to it, which is that a large premium is usually required to convince the shareholder of the target company to accept the offer. In such cases, the shareholders of the acquiring companies get disappointed by the fact that their company is issuing huge premiums to another company's shareholders, and thus the shareholders of the acquiring company sell their shares which further results in decreasing their value.

Synergies and economies of scale This is usually one of the primary motivating factors for small companies as they have limited resources and usually deal with financial constraints. Companies merge to take advantage of synergies and economies of scale. Synergies occur when two companies who deal with the similar type of business combine with each other, as they can then consolidate or eliminate duplicate resources like a branch and regional offices, manufacturing facilities, research projects etc. Every amount of money which is saved goes straight to the bottom line, boosting earnings per share and making the M&A transaction an "accretive" one.

Tax purposes Companies also enter M&A agreements for tax purposes, although this may be an implied rather than an overt motive. For instance, countries like U.S., have a huge corporate tax rate, so to avoid payment of these taxes, some American companies have resorted to corporate "inversions". This involves a U.S. company buying a smaller foreign competitor and moving the merged entity's tax home overseas to a lower-tax jurisdiction, in order to substantially reduce its tax bill.[20]

5.4 CONS OF MERGERS AND ACQUISITIONS

Substantial Increase in Prices A merger reduces competition and thus can give the acquiring company the monopoly power in the market.[21] With less competition and greater market

[19] http://www.investinganswers.com/financial-dictionary/economics/mergers-acquisitions-ma-366
[20] www.investopedia.com/ask/answers/06/mareasons.asp
[21] E. Picardo, How Mergers and Acquisitions Can Affect A Company

share, the new firm can increase prices of the products for consumers. For example, let's consider a hypothetical situation, where some major automobile companies merge with each other, the probable outcome is that they will substantially increase the prices of their product, because of the fact that the consumers will not do not have many options to choose from thus leaving them with no other option but to purchase those products at the increased prices. Thus, this is one of the biggest drawbacks of the M&As, wherein the market is highly disrupted, and the consumers are the ultimate sufferers.[22]

Job Losses: A merger can lead to a situation wherein the employees have to lose their jobs. Usually, while a merger or acquisition takes place, the companies tend to reduce and remove those assets which will not be resulting in their profiting rearing process. This is a particular reason for concern if it is an aggressive takeover by an 'asset stripping' company. An asset stripping company is a company, which seeks to merge and get rid of under-performing sectors of the target company.

Diseconomies of Scale: The new company may experience diseconomies of scale from the increased size. After a merger, since the size of the company is increased, it may lack the same degree of control and thus may struggle to motivate workers. If workers feel they are just part of a big multinational, they may be less motivated to try hard.

Loss in productivity: In cases where the small companies are being merged or acquired by big companies, the employees of the small companies may require exhaustive re-skilling. Thus, the time during which is required for such re-skilling, the company will have to suffer the non- productivity of those employees, which indirectly would cast a burden on the capital of the company[23].

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[22] T. Pettinger, Pros and Cons of Mergers, available at http://www.economicshelp.org/blog/5009/economics/pros-and-cons-of-mergers/

[23] Y. Kumar, Advantages And Disadvantages Of Mergers And Acquisition Economics Essay, available at http://www.ukessays.com/essays/economics/advantages-and-disadvantages-of-mergers-and-acquisition- economics-essay.php

CHAPTER 6

RATIONALE BEHIND MERGERS AND ACQUISITIONS

6.1 MOTIVES BEHIND M&A (MERGERS AND ACQUISITIONS)

The dominant rationale used to explain M&A activity is that acquiring firms seek improved financial performance. The following motives are considered to improve financial performance:

1. **Synergies:** This refers to the fact that the combined company can often reduce its fixed costs by removing duplicate departments or operations, lowering the costs of the company relative to the same revenue stream, thus increasing profit margins. Increased revenue/Increased Market Share: This assumes that the buyer will be absorbing a major competitor and thus increase its market power (by capturing increased market share) to set prices.
2. **Cross selling:** For example, a bank buying a stock broker could then sell its banking products to the stock broker's customers, while the broker can sign up the bank's customers for brokerage accounts. Or, a manufacturer can acquire and sell complementary products. Economies of Scale: For example, managerial economies such as the increased opportunity of managerial specialization. Another example are purchasing economies due to increased order size and associated bulk-buying discounts.
3. **Taxes:** A profitable company can buy a loss maker to use the target's loss as their advantage by reducing their tax liability. In the United States and many other countries, rules are in place to limit the ability of profitable companies to "shop" for loss making companies, limiting the tax motive of an acquiring company.
4. **Geographical or other diversification**: This is designed to smooth the earnings results of a company, which over the long term smoothens the stock price of a company, giving conservative investors more confidence in investing in the company. However, this does not always deliver value to shareholders.
5. **Resource transfer:** Resources are unevenly distributed across firms (Barney, 1991) and the interaction of target and acquiring firm resources can create value through either overcoming information asymmetry or by combining scarce resources.
6. **Vertical integration:** Vertical Integration occurs when an upstream and downstream firm merge (or one acquires the other). There are several reasons for this to occur. One

reason is to internalize an externality problem. A common example is of such an externality is double marginalization. Double marginalization occurs when both the upstream and downstream firms have monopoly power; each firm reduces output from the competitive level to the monopoly level, creating two deadweight losses. By merging the vertically integrated firm can collect one deadweight loss by setting the upstream firm's output to the competitive level. This increases profits and consumer surplus. A merger that creates a vertically integrated firm can be profitable. However, on average and across the most commonly studied variables, acquiring firms' financial performance does not positively change as a function of their acquisition activity. Therefore, additional motives for merger and acquisition that may not add shareholder value include:

7. **Diversification:** While this may hedge a company against a downturn in an individual industry it fails to deliver value, since it is possible for individual shareholders to achieve the same hedge by diversifying their portfolios at a much lower cost than those associated with a merger.
8. **Manager's compensation:** In the past, certain executive management teams had their payout based on the total amount of profit of the company, instead of the profit per share, which would give the team a perverse incentive to buy companies to increase the total profit while decreasing the profit per share (which hurts the owners of the company, the shareholders); although some empirical studies show that compensation is linked to profitability rather than mere profits of the company.

6.2 MOTIVATION BEHIND MERGER AND ACQUISITION IMPROVING FINANCIAL PERFORMANCE OR REDUCING RISK

The dominant rationale used to explain M&A activity is that acquiring firms seek improved financial performance or reduce risk. The following motives are considered to improve financial performance or reduce risk:

- **Economy of scale:** This refers to the fact that the combined company can often reduce its fixed costs by removing duplicate departments or operations, lowering the costs of the company relative to the same revenue stream, thus increasing profit margins.
- **Economy of scope:** This refers to the efficiencies primarily associated with demand-

side changes, such as increasing or decreasing the scope of marketing and distribution, of different types of products.

- **Increased revenue or market share:** This assumes that the buyer will be absorbing a major competitor and thus increase its market power (by capturing increased market share) to set prices.
- **Cross-selling:** For example, a bank buying a stock broker could then sell its banking products to the stock broker's customers, while the broker can sign up the bank's customers for brokerage accounts. Or, a manufacturer can acquire and sell complementary products.
- **Synergy:** For example, managerial economies such as the increased opportunity of managerial specialization. Another example is purchasing economies due to increased order size and associated bulk-buying discounts.
- **Taxation:** A profitable company can buy a loss maker to use the target's loss as their advantage by reducing their tax liability. In the United States and many other countries, rules are in place to limit the ability of profitable companies to "shop" for loss making companies, limiting the tax motive of an acquiring company.
- **Geographical or other diversification:** This is designed to smooth the earnings results of a company, which over the long term smoothens the stock price of a company, giving conservative investors more confidence in investing in the company. However, this does not always deliver value to shareholders (see below).
- **Resource transfer:** resources are unevenly distributed across firms (Barney, 1991) and the interaction of target and acquiring firm resources can create value through either overcoming information asymmetry or by combining scarce resources.[24]
- **Vertical integration:** Vertical integration occurs when an upstream and downstream firm merge (or one acquires the other). There are several reasons for this to occur. One reason is to internalize an externality problem. A common example of such an externality is double marginalization. Double marginalization occurs when both the

[24] King, D. R.; Slotegraaf, R.; Kesner, I. (2008). "Performance implications of firm resource interactions in the acquisition of R&D-intensive firms". Organization Science. 19 (2)

upstream and downstream firms have monopoly power and each firm reduces output from the competitive level to the monopoly level, creating two deadweight losses. After a merger, the vertically integrated firm can collect one deadweight loss by setting the downstream firm's output to the competitive level. This increases profits and consumer surplus. A merger that creates a vertically integrated firm can be profitable.[68]

- **Hiring:** some companies use acquisitions as an alternative to the normal hiring process. This is especially common when the target is a small private company or is in the startup phase. In this case, the acquiring company simply hires ("acquires") the staff of the target private company, thereby acquiring its talent (if that is its main asset and appeal). The target private company simply dissolves and few legal issues are involved.
- Absorption of similar businesses under single management: similar portfolio invested by two different mutual funds namely united money market fund and united growth and income fund, caused the management to absorb united money market fund into united growth and income fund.
- Access to hidden or nonperforming assets (land, real estate).
- Acquire innovative intellectual property.
- Megadeals—deals of at least one $1 billion in size—tend to fall into four discrete categories: consolidation, capabilities extension, technology-driven market transformation, and going private.

Other types

However, on average and across the most commonly studied variables, acquiring firms' financial performance does not positively change as a function of their acquisition activity.[71] Therefore, additional motives for merger and acquisition that may not add shareholder value include:

- **Diversification:** While this may hedge a company against a downturn in an individual industry it fails to deliver value, since it is possible for individual shareholders to achieve the same hedge by diversifying their portfolios at a much lower cost than those associated with a merger. (In his book One Up on Wall Street, Peter Lynch termed this "diversification".)
- **Manager's hubris:** manager's overconfidence about expected synergies from M&A

which results in overpayment for the target company.

- **Empire-building:** Managers have larger companies to manage and hence more power. Manager's compensation: In the past, certain executive management teams had their payout based on the total amount of profit of the company, instead of the profit per share, which would give the team a perverse incentive to buy companies to increase the total profit while decreasing the profit per share (which hurts the owners of the company, the shareholders).

6.3 BENEFIT OF MERGER AND ACQUISITION

Benefits of Mergers and Acquisitions are manifold. Mergers and Acquisitions can generate cost efficiency through economies of scale, can enhance the revenue through a gain in market share and can even generate tax gains.

The principal benefits from mergers and acquisitions can be listed as increased value generation, increase in cost efficiency and increase in market share. Benefits of Mergers and Acquisitions are the main reasons forwhich the companies enter into these deals. Mergers and Acquisitions may generate tax gains, can increase revenue and can reduce the. cost of capital.[25]

The main benefits of Mergers and Acquisitions are the following:

Greater Value Generation

Mergers and acquisitions often lead to an increased value generation for the company. It is expected that the shareholder value of a firm after mergers or acquisitions would be greater than the sum of the shareholder values of the parent companies. Mergers and acquisitions generally succeed in generating cost efficiency through the implementation of economies of scale.

Merger & Acquisition also leads to tax gains and can even lead to a revenue enhancement through market share gain. Companies go for Mergers and Acquisition from the idea that, the joint company will be able to generate more value than the separate firms. When a company buys out another, it expects that the newly generated shareholder value will be higher than the

[25] King, D. R.; Dalton, D. R.; Daily, C. M.; Covin, J. G. (2004). "Meta-analyses of Post-acquisition Performance: Indications of Unidentified Moderators". Strategic Management Journal. 25 (2): 187– 200. doi:10.1002/smj.371.

value of the sum of the shares of the two separate companies.

Mergers and Acquisitions can prove to be really beneficial to the companies when they are weathering through the tough times. If the company which is suffering from various problems in the market and is not able to overcome the difficulties, it can go for an acquisition deal. If a company, which has a strong market presence, buys out the weak firm, then a more competitive and cost-efficient company can be generated. Here, the target company benefits as it gets out of the difficult situation and after being acquired by the large firm, the joint company accumulates larger market share. This is because of these benefits that the small and less powerful firms agree to be acquired by the large firms.

Gaining Cost Efficiency[73]

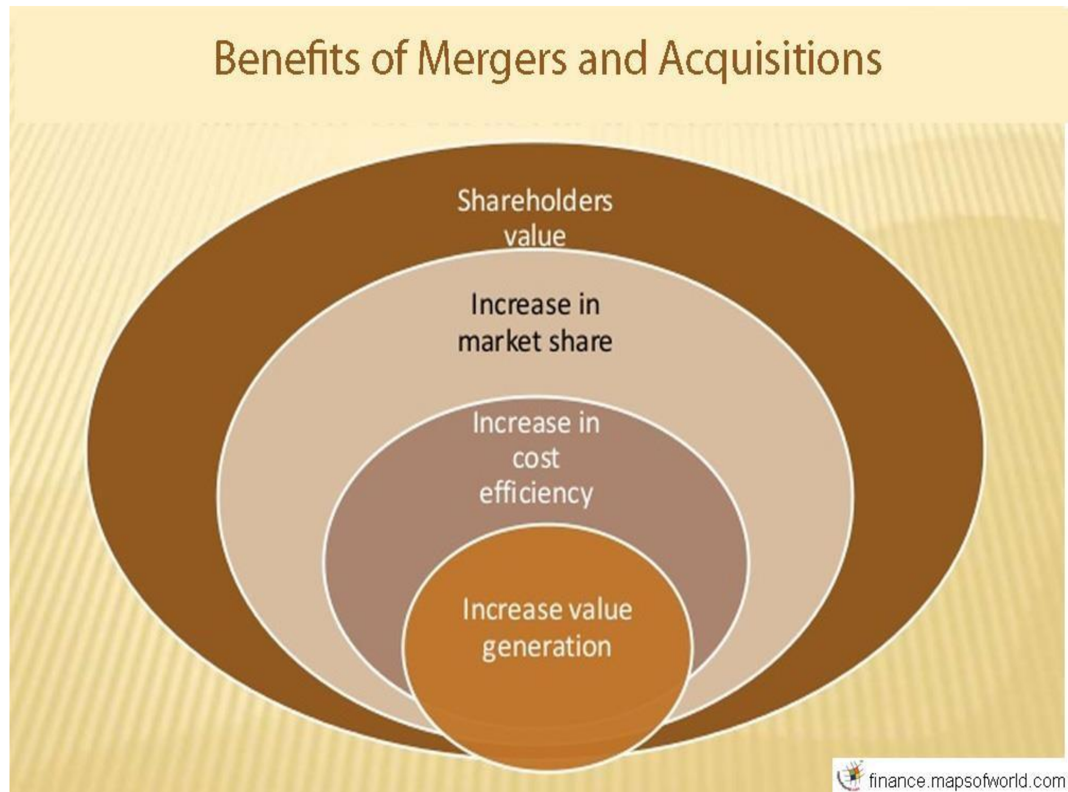
When two companies come together by merger or acquisition, the joint company benefits in terms of cost efficiency. A merger or acquisition is able to create economies of scale which in turn generates cost efficiency. As the two firms form a new and bigger company, the production is done on a much larger scale and when the output production increases, there are strong chances that the cost of production per unit of output gets reduced.

An increase in cost efficiency is affected by the procedure of mergers and acquisitions. This is because mergers and acquisitions lead to economies of scale. This, in turn, promotes cost efficiency. As the parent firms amalgamate to form a bigger new firm the scale of operations of the new firm increases. As output production rises there are chances that the cost per unit of production will come down.

Mergers and Acquisitions are also beneficial

- When a firm wants to enter a new market
- When a firm wants to introduce new products through research and development
- When a firm wants to achieve administrative benefits
- To increased market share
- To lower cost of operation and/or production
- To gain higher competitiveness
- For industry know-how and positioning

- For Financial leveraging
- To improve profitability and EPS



An increase in market share is one of the plausible benefits of mergers and acquisitions. In case a financially strong company acquires a relatively distressed one, the resultant organization can experience a substantial increase in market share. The new firm is usually more cost-efficient and competitive as compared to its financially weak parent organization.

6.4 EMPLOYEE BENEFIT UNDER MERGER AND ACQUISITION

A change in corporate ownership such as a merger or an acquisition often entails significant change to employee working conditions. Employees may need to be reallocated or transferred between the existing and the acquired units, for example, contracts may need to be renegotiated and in the event of employee termination settlement packages may need to be worked out.
Given the complexity of Indian labor law, businesses making acquisitions must carefully design

their labor retention, redeployment and/or retrenchment (layoff) plans to ensure compliance with.[75]

Determination of Employee Status

According to a recent paper from Singhania & Partners emailed to Bloomberg BNA, the first step in ensuring compliance with employment laws is to determine the exact status of an employee under the relevant statutes, since procedures and conditions for termination of employment, for example, vary depending on whether the worker legally qualifies as a "workman" or a "consultant" (contractor).[26]

"There are a number of statutory and judicially defined criteria that have to be applied to the employment agreements or appointment letters to determine the exact status in each case," the paper states. In Balwant Rai Saluja vs. Air India Ltd, the Supreme Court of India applied the integrated test approach, evaluating a set of factors—including control over the employee, supervision and direction of work, issuing of instructions and power of recruitment, termination or dismissal—to determine whether in a given set of circumstances a person is an employee or an independent contractor.[27]

The Industrial Disputes Act and the Shops and Establishments Acts of individual states specify the procedure for issuing notices and the grounds for termination without cause (where permitted), and it is important to bear in mind that in most cases only "with cause" termination is permitted.

The type of industry (service or manufacturing) and the number of employees determine whether notice of termination must be given to the government or prior permission requested.

Transfer or Layoff

When an existing business is acquired by another and ownership transfers to the new entity, "workmen" may or may not be transferred to the new undertaking. (The Industrial Disputes Act 1947 defines "workman" as "any person (including an apprentice) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire

[26] https://www.bna.com/india-treatment-employees-n57982079060/ /
[27] https://www.bna.com/india-treatment-employees-n57982079060/

or reward, whether the terms of employment be express or implied.")

The Supreme Court of India has held that, if workmen are to be transferred to the new owner, the old employer must obtain the consent of the affected workers even if there is no change in their terms of service and they are transferred on no less favorable terms. If terms of employment will change, the original employer must give notice to the workmen and obtain their consent.

In Monthly Rated Workmen v. Indian Hume Pipe Co, the Supreme Court of India held that a benefit prevailing for so long that it has become a condition of service cannot be withdrawn in the absence of compelling reasons. In practice, this means that employers must attempt to negotiate a settlement with affected workers to obtain their consent to the proposed changes. In Sunil Kr. Ghosh v. K. Ram Chandran, the Supreme Court held: "It is settled law that without consent, workmen cannot be forced to work under different management and in that event, those workmen are entitled to retirement/retrenchment compensation."

Continuous Employment

Employment is to be treated as continuous and not interrupted by the transfer of ownership, and the terms and conditions of the workmen's service cannot be in any way less favorable than those in place immediately prior to the transfer of ownership.

In addition, the buyer and the seller must sign an agreement under which the workmen's seniority or period of service is maintained after the transfer of ownership for the purpose of social security benefits. This also involves transfer of provident (retirement) fund accounts and balances to the new owner.

Singhania & Partners notes that under Sunil Kr. Ghosh, "new employers must undertake due diligence to ensure that the appropriate deductions of statutory contributions were made by the old employer and only then take over the accounts." Courts insist that the buyer incur the social security obligations as a successor employer.

Workers who don't want to transfer to the new owner and whom the previous owner will not continue to employ must be paid all compensation due and all termination benefits under the appropriate settlement agreements.

If the transfer of employment must take place on less favorable terms, workmen who agree to

resign from the old employer and move to the new one are due severance benefits as stipulated in the Industrial Disputes Act. Workmen with at least five years' continuous employment are also entitled to gratuity benefits. (Under the Payment of Gratuity Act, employees who have completed five years' continuous service at the time of retirement, resignation, death or disability are entitled to a payment equivalent of 15 days' salary for every completed year of service up to 1 million rupees.)

Redeployment

Acquisitions or mergers may necessitate changes in job titles, duties and service conditions. Under the Industrial Disputes Act, the conditions of service of any workman—particularly in matters such as wages, employer contributions to provident or pension funds, hours of work, leave with wages and holidays and disciplinary procedures—cannot be changed without giving prior notice to the workmen likely to be affected. If the workmen object to the proposed changes, management must negotiate.

According to Singhania & Partners, "if the two sides do not agree on a way out, then litigation proceedings can be long and contentious." "Managerial or supervisory employees who may not be 'workmen' may be a simpler category of resources to redesign, depending on the type of employment contract, its duration, and provisions for termination or renewal," Singhania says, noting, however, that under the Law of Contract, the employer may be required to seek the consent of the affected employee or renegotiate the agreement.

Negotiating 'Voluntary' Exits

"Given that termination of employment poses a host of legal challenges, it is better sometimes to consider softer options like negotiating voluntary exits (instead of terminations), or gradual separation of smaller numbers of employees rather than executing bulk discharge of employees," Singhania & Partners says. "This option is preferable to more drastic measures but also requires careful drafting of settlement agreements and termination letters which must work around the delicate issue of grounds of removal such that employees are not left feeling aggrieved that the terms of their employment were violated or they were treated unfairly."

6.5 EMPLOYEE TRANSFERS AT THE TIME OF MERGERS AND ACQUISITIONS

Transfer of an undertaking: International Perspective[28]

The term 'transfer of undertaking' has a wide connotation. The EU Council Directive has defined it in a precise manner by stating that it is "a transfer of an economic entity which retains its identity, meaning an organized grouping of resources which has the objective of pursuing an economic activity, whether or not that activity is central or ancillary".[29]

In this regard, it is important to know the nuances between the 'successorship doctrine' and the 'doctrine of a continuing employer'. Successorship doctrine is ordinarily applied to determine obligations when one corporate entity is replaced by another, i.e., when there has been a complete change of ownership. However, the concept of "successorship," unlike that of the single employer, contemplates "the substitution of one employer for another, where the predecessor employer either terminates its existence or otherwise ceases to have any relationship to the ongoing operations of the successor employer.[30]" In contrast to a stock 'doctrine of a continuing employer', where a continuing employer remains bound by its collective bargaining agreement, a successor is not bound by the substantive terms of its predecessor's labour/employment agreement.

Mostly in Mergers, cases where there is a sale or transfer of stock and no change in corporate form, "successorship doctrine" gives way to the doctrine of a "continuing employer." For example, in *EPE, Inc. vs. NLRB*[31], the court enforced the Board's order holding that where there was a 100 percent stock sale, no termination of operations or employees, and no severance payments made, "there was effectively no change of corporate employers" even though new equipment and product lines were added. The continuing employer is obliged to adopt the substantive provisions of the collective bargaining agreement, as well as to recognize and bargain with the incumbent union. However, in Asset Purchase, the purchaser of assets, although not bound to the substantive provisions of the collective bargaining agreement, but may incur other

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[28] https://www.bna.com/india-treatment-employees-n57982079060/

[29] 2001/23/EC (the revised Transfer of Undertakings Directive)

[30] TKB Int'l Corp., 240 N.L.R.B. at 1083 n. 4

[31] 845 F2d 483 (4th Cir 1988)

obligations as a successor employer.

6.6 POSITION IN INDIA

Who is Workman?

The Industrial Disputes Act, 1947 is the governing legislation that provides the machinery and procedure for the amicable settlement of conflicts between employer and employee. To determine whether or not an employee is a 'workman' within the meaning of this Act has always been a subject of constant controversy before the Courts in India. The reason being, when an employee is involved in a dispute with the employer or in a situation where his employment is terminated and such individual wants to avail the protective umbrella of the Act, the employer always contests by raising an objection that the employee is not a 'workman' within the definition of the Act. At the time of any corporate deal or restructuring, the employees of a business entity do not automatically get transferred to the purchasing company and thus their grievances can be addressed only if they can be classified as a 'workman' before the eyes of law. As per Section 2(s) of the Act, a "workman" means any person (even including an apprentice) who is employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, regardless of whether the terms of employment are express or implied. For the purpose of any industrial dispute, the definition also includes any person who may be dismissed, discharged or retrenched in connection with, or as a consequence of, that dispute. It is important to note that this definition of "workman" does not include a person who may be employed primarily in a managerial or administrative capacity.

Compensation to Workman at the time of Transfer of Undertaking

Section 25FF of the Industrial Disputes Act, 1947 provides for Compensation to workmen in case of transfer of undertakings. Thus, for an employee to get compensation under Section 25FF, three conditions need to be satisfied.

First, the workman's term of service should be uninterrupted. Second, the terms and conditions of service stipulated by transferee should be at par with the transferor. Third, the new employer should undertake to pay retrenchment compensation to the workmen on the basic premise that there was continuous service and the continuity was not hampered due to transfer of

undertaking. Such provision has given rise to litigation wherein many conflicting judgments have been passed.

Transfer of Undertaking: Procedure for Workman

Seller in an Asset Purchase has an obligation to provide termination notice and compensation to workmen if the prospective Buyer refuses to employ them and Seller does not wish to keep the employees working for a different division. If the Buyer voluntarily decides to employ these employees, it would be obliged to acknowledge their seniority for all purposes (including a future termination) and to provide the same terms and conditions of employment which they had with seller. A possible procedure for this would be:

a. Seller holds informal discussions with employees, either collectively or individually, and informs them that they have an opportunity to join Buyer. Buyer may join these discussions to address the concerns the affected employees may have as a result of the transfer. Employees are asked to resign from their current employment and, simultaneously with their resignation, an offer letter would be issued to them by the Buyer. The offer letter will acknowledge seniority for all purposes and provide the same terms and conditions of employment.
b. On the date of Closing, Seller accepts the resignations, waives employees' notice, and makes any outstanding payments due to the employees. The new employment agreements are executed reiterating the terms of the offer letter. It is also advisable to have the employees execute a "no claim letter" (i.e., waiver and release of future claims) in favour of the Seller.

Transfer of Undertaking: Procedure for Non-workman

The rights for non-workmen in case of a transfer of an undertaking are governed by the terms and conditions of their employment contracts.

If the Buyer refuses to employ them and the Seller does not wish to keep the employees, Seller will only have to provide them with their contractual termination entitlements.

However, if the Buyer voluntarily decides to employ these employees, the employment agreements must be terminated and the selected employees hired by the Buyer, for which a

procedure very similar to the one described above for workmen can be followed (unless special contractual provisions apply). The main difference would be that the offer letter does not have to acknowledge seniority or to provide the same terms and conditions, although it is advisable to do so to ensure that the employees accept the offer.

Continuity of Service

Most employees are entitled to earn such rights as vacations, pregnancy and parental leaves, termination and severance pay. However, they are not eligible to receive them until they have worked for an employer for a certain minimum time, which varies according to each kind of right. The continuity of employment provisions provides that a person's length of employment with the Seller of a business is attributed, or "flows through" to the purchaser of the business. This means that an employee's entitlements to rights that are based on length of employment are unchanged, despite the sale of the business or the change in building service providers.

When a person's length of employment is attributed to a new employer, the new employer has to recognize the time the person worked for the previous employer. This "earned" time must be credited toward any rights the employee has that are based on his or her length of employment.

Seller has to compensate the workmen if they are not employed by the Buyer or even when the Buyer does not allocate any work to them in another division. If the Buyer employs such employees on his own volition, then such Buyer has to take into the account the seniority status enjoyed by the employee in the transferor.[32]

In majority number of cases where unions are party to an agreement with the employers, for any corporate decision that has impact on workers' rights and obligation, then such union representatives have to be intimated about the same and they should be consulted as well. The transfer of business does not incorporate transfer of employees to the transferee company. Employers can retain the employees or terminate their contracts on giving notice, depending on the provisions of applicable laws and their employment contract.

Also, if the terms and conditions that govern the transferee company are more attuned to the employees' interests than the transferor company, then in such a case protective termination

[32] S.D. Puri and Sandeep Puri, Treatise on Industrial Disputes Act, 1967, (Snowhite Publications, 2009)

provisions will not be invoked. The Industrial Disputes Act, 1947 provides for retrenchment compensation in cases of transfer or closure of undertaking.

Retrenchment Compensation

As regards for retrenchment compensation, the position which held the ground till ***Sunil Kr. Ghosh vs. K. Ram Chandran***[33] decided in November 2011 was that, in most of the mergers and acquisitions where there was a change of ownership or management of an industrial undertaking on a going concern basis and there was no variation in the terms of employment of the workmen as part of the transaction, **there was no requirement to obtain consent of workmen or to pay retrenchment compensation** to any workman who did not wish to continue working under the new management. With *Sunil Kr. Ghosh* Case[34] the position changed and now no workmen can be forced to work under a new management even when the terms of employment under the new management are no less favourable as those applicable prior to the transfer. The Apex Court in this case held: "*It is settled law that without consent, workmen cannot be forced to work under different management and in that event, those workmen are entitled to retirement / retrenchment compensation in terms of the Act. In view of the same, we are of the view that the workmen are entitled to the benefit of such direction and it is the obligation on the part of the Management- Philips India Limited, to comply with the same*." This effect of this judgment is that, contrary to the judgments given by this Court earlier, the present case makes it mandatory for the Acquirers and Sellers in any merger or acquisition involving a change in management or ownership of an undertaking to take prior consent from workmen. In case such workman does not consent to such transfer, they will be entitled to retrenchment compensation in terms of Section 25F (Condition's precedent to retrenchment of workmen) of the Act. Section 25F of the Act provides for the amount of retrenchment compensation to be paid at the time of retrenchment. The compensation should be equivalent to fifteen days' average pay of the workman for every completed year of continuous service or any part thereof in excess of six months.

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[33] 2011(13)SCALE23

[34] 2011(13)SCALE23

Legitimate Expectation of the Employees

The employees will have a legitimate expectation that the management will uphold their right and ensure they are benefitted during the transfer. In ***Ram Pravesh Singh and Ors. vs. State of Bihar and Ors.***[35] this aspect of legitimate expectation was elaborately discussed. In the case the employees contended that their legitimate expectations that they would be employed in the firm after the transfer arose due to the following reasons:

1. A similar situation in the past where all private companies were taken over and their employees were absorbed;
2. Whenever the undertaking of any company or institution was taken over by any statutory body or corporation like the current situation, the services of employees of such undertaking are also normally taken over;
3. When an 'undertaking' is purchased, in the absence of an intention to the contrary, all the assets and liabilities, as also the services of all employees are transferred to the purchaser and therefore the Board cannot refuse to absorb them
4. All the employees of the society have crossed the maximum age limit for seeking fresh employment and if they were not absorbed by the Board, they will be deprived of their livelihood.
5. When the undertakings of such instrumentality of the state was taken over by another instrumentality of the State, 'fairness in action' which is one of the hallmarks of a 'State' (Article 12 of the Constitution of India) requires that the rights of the employees are protected by providing for their absorption in an appropriate manner.

   The court thus held that, a person can be said to have a 'legitimate expectation' of a particular treatment, if any representation or promise is made by an authority, either expressly or impliedly, or if the regular and consistent past practice of the authority gives room for such expectation in the normal course. Hence where this legitimate expectation persists there is a need to meet such expectations and give effect to the

[35] Ram Pravesh Singh and Ors. Vs: State of Bihar and Ors [2007(113)FLR639]

rights of the employees.[36]

Procedure for Transfer of Provident Fund

A resigned employee who joins another company is left with an option of transferring the PF monies from his previous PF account to the current PF account, by filling the Form 13. When an employee joins new company and he wishes to transfer his previous company provident fund amount, he should inform the HR department or Accounts department of the new company. The employer will issue Form 13, in which the member has to fill the details of previous company like – name, address, provident fund account number and address of the provident fund office where the account was held. It is to be noted that the signature of the previous employer is not required on Form 13. Once he/she fills the required details and submit it to the current employer, the current employer will forward it to the provident fund office for transferring process. The time taken for transferring the fund from one account to other account normally takes about 40 days from date of submission.[37]

Problem during Transfer of Monies

In the case of transfer and when the previous employer is an exempted establishment (which means, having its own PF trust), the procedures requires that the current employer should forward the transfer form, i.e. Form 13 to the previous employer who will process a cheque (after validation) in favour of PF office of the current employer and it will be sent to the current employer. Here, the normal problems that might occur are:

- Previous employer might have changed their address;
- Documents lost in transit / do not reach the concerned department;
- Delay in processing the application for reasons like tedious internal processing procedures, signatory not available etc.[38]

[36] https://indiancaselaws.wordpress.com/2014/08/19/employee-transfers-in-mergers-and-acquisitions/

[37] https://indiancaselaws.wordpress.com/2014/08/19/employee-transfers-in-mergers-and-acquisitions/

[38] https://indiancaselaws.wordpress.com/2014/08/19/employee-transfers-in-mergers-and-acquisitions/

CHAPTER 7

PROCEDURE AND CONDITIONS OF MERGER & ACQUISITION REASONS FOR MERGER & ACQUISITION

7.1 PROCEDURE OF MERGER AND ACQUISITION IN INDIA

Mergers And Acquisitions

A business may grow over time as the utility of its products and services is recognized. It may also grow through an inorganic process, symbolized by an instantaneous expansion in work force, customers, infrastructure resources and thereby an overall increase in the revenues and profits of the entity. Mergers and acquisitions are manifestations of an inorganic growth process. While mergers can be defined to mean unification of two players into a single entity, acquisitions are situations where one player buys out the other to combine the bought entity with itself. It may be in form of a purchase, where one business buys another or a management buyout, where the management buys the business from its owners. Further, de-mergers, i.e., division of a single entity into two or more entities also require being recognized and treated on par with mergers and acquisitions regime as recommended below, and accordingly references below to mergers and acquisitions also is intended to cover de-mergers (with the law & Rules as framed duly catering to the same).

Mergers and acquisitions are used as instruments of momentous growth and are increasingly getting accepted by Indian businesses as critical tool of business strategy. They are widely used in a wide array of fields such as information technology, telecommunications, and business process outsourcing as well as in traditional business to gain strength, expand the customer base, cut competition or enter into a new market or product segment. Mergers and acquisitions may be undertaken to access the market through an established brand, to get a market share, to eliminate competition, to reduce tax liabilities or to acquire competence or to set off accumulated losses of one entity against the profits of other entity.

The process of mergers and acquisitions in India is court driven, long drawn and hence problematic. The process may be initiated through common agreements between the two parties, but that is not sufficient to provide a legal cover to it. The sanction of the High Court is required for bringing it into effect. The Companies Act, 1956 consolidates provisions relating to mergers and acquisitions and other related issues of compromises, arrangements and reconstructions, however other provisions of the

Companies Act get attracted at different times and in each case of merger and acquisition and the procedure remains far from simple.

The Central Government has a role to play in this process and it acts through an Official Liquidator (OL) or the Regional Director of the Ministry of Company Affairs. The entire process has to be to the satisfaction of the Court. This sometimes results in delays.

Needless to say, in the context of increasing competitiveness in the market, speed is of the essence, especially in an expanding and vibrant economy like ours. A sign of corporate readiness, skill and stratagem is the ability to do such mergers and acquisitions with ‘digital’ speed. E-governance could provide a helpful tool in achieving the objective of speed with provisions for online registration, approvals etc.[39]

The Committee was of the view that contractual mergers may be given statutory recognition in the Company Law in India as is the practice in many other countries. Such mergers and acquisitions through contract form (i.e., without court intervention), could be made subject to subsequent approval of shareholders by ordinary majority. This would eliminate obstructions to mergers and acquisitions, ex-post facto protection and ability to rectify would be available. There has been a steady increase in cross-border mergers with the increase in global trade. Such mergers and acquisitions can bring long-term benefits when they are accompanied by policies to facilitate competition and improved corporate governance.

The Committee went into several aspects of the provisions in the existing law constituting a separate code in themselves and regulating a very important aspect of restructuring and consolidation of business in response to the economic environment. An effort was made to identify the areas of concern under the present law and to recommend means of addressing them.

At present, in case of a proposed scheme for amalgamation of company which is being dissolved without winding up, the law requires a report from the Official Liquidator (OL) or Registrar of Companies (ROC) that the affairs of company have not been conducted in a manner prejudicial to the interest of its members or to public interest. The Act also requires that no order for dissolution of any transferor company shall be made by the Court unless the OL makes a report to the Court that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members

[39] http://www.mca.gov.in/MinistryV2/mergers+and+acquisitions.html

or to public interest. The Committee felt that the above two requirements under the present law can be covered by issuing notices to ROC and OL respectively; who may file before the Court, information that may have a bearing on the proposed merger. There is no requirement of a separate information in response to the notice to be filed for the purpose. Filing of such report may be time-bound, beyond which it may be presumed that ROC/OL concerned have no comments to offer.

Single window concept

The law should provide for a single forum which would approve the scheme of mergers and acquisition in an effective time bound manner. The law should also provide for mandatory intimation to regulators in respect of specified class of companies. The concept of 'deemed approval' should be provided for in cases where the regulators do not intimate/inform their comments within a specified time period to the Court/Tribunal before which the scheme of merger/amalgamation is submitted for approval.

Valuation of shares

The Committee while discussing this aspect in detail, also took into account the Shroff Committee Report on "Valuation of Corporate Assets and Shares" during the course of its deliberation on the subject and took the view that valuation of the shares of companies involved in schemes of mergers should be made mandatory in respect of such companies. It was also recommended that such valuation should be carried out by independent registered valuers rather than by Court appointed valuers. The law should lay out the exception, if any, to the mandatory valuation requirements. The law should also recognize valuation of incorporeal property. Valuation standards may also be developed on the lines of 'International Valuation Standards' issued by the International Valuation Standards Committee. The valuation should be transparent so that the aggrieved person may get an opportunity to challenge the same before Court/Tribunal. Benchmarking of valuation techniques and Peer Review Mechanism for Valuers should also be provided for.

Where an Audit Committee is mandatory for a company, the task of appointing the valuer should be entrusted to the Audit Committee. The Audit Committee should also have the duty to verify whether the valuer has an advisory mandate and had past association with the company management. The Audit Committee should verify the independence of the valuer for

the purposes of an independent valuation. In the case of companies not required to have Audit Committee, this task should be carried out by the Board.

Registration of merger and acquisition

The Committee discussed with concern, the differential stamp duty regime prevalent in different States, which inhibits merger and acquisition activity. It has been a question for consideration whether an order of a court sanctioning a compromise/arrangement under Sections 391-394 of the Companies Act, 1956 would be stamp able as a "conveyance" at the rates applicable to such entry in the various state Stamp Acts. Certain states like Maharashtra, Gujarat, Karnataka and Rajasthan sought to address this problem by amending their stamp legislations to make an order of the High Court under Sections 391-394 stamp able. However, majority of the states in India have not adopted this stand, resulting in a confusion on the issue. This confusion is more acutely present in the case of mergers of companies that have registered offices in different states. However, as this subject falls within the domain of the States under the Constitution, the States will have to take initiative in this regard. It would be appropriate for the Central Government to facilitate a dialogue in this regard.

1. The Concept Paper on Company Law (2004) contemplates that an order of the scheme of merger will be effective only if a certified copy of the order of the Court is filed with the Registrar and duly registered. The Committee felt that it should be enough if the company complies with the filing requirement with the Registrar of Companies as is presently provided, to make the scheme effective.
2. The Committee also felt that a separate electronic registry should be constituted for filing schemes under Sections 391/394 of the Companies Act. Instead of filing the schemes with the Registration Offices wherever the properties of the company are located, filing the scheme with the electronic registry should be considered sufficient compliance. This however, could raise jurisdictional issues vis-à-vis Stamp Duties applicable which may be resolved by an appropriate Constitutional amendment to enable a uniform, reasonably priced Stamp Duty regime across the country. Further, there must also be a provision in the Company Law for compulsory registration with the electronic registry of all property of a company above a certain value. This will simplify the mutation procedure subsequent to scheme of arrangement between two or more companies. The Committee took the view that enabling uniformity and overall reduction of Stamp Duties applicable in pursuance of mergers, demergers, amalgamations or schemes of reconstruction,

takeover would be desirable as competition requires cost reduction and Indian firms need to be competitive in restructuring exercise in the global context.

Merger of a listed company into an unlisted company and vice-versa

1. The Committee examined issues relating to the merger of listed company with an unlisted company and vice-versa. It was felt that the Act needs to provide specifically that de-listing through a scheme of merger under section 391-394 of the Companies Act is possible by merging a listed company with an unlisted company. However, such a process should enable a safety net or a clear exit option for the public shareholders of the listed company. Similarly, if substantial assets are moved out of a listed company in the case of de-merger, a safety net/exit option needs to be provided to the public shareholders and the residual company needs to be de-listed (in case more than 90% of the public shareholders exercise such option).
2. The law should enable companies to purchase the stake of minority shareholders in order to prevent exploitation of such shareholders where a promoter has bought back more than 90% of the equity. Such purchase should, however, on the basis of a fair offer. Appropriate valuation rules for this purpose should be prescribed, or, the last known price prior to delisting, could be made the benchmark for such acquisitions.[40]

Approval of the Scheme

1. The existing Law requires that a scheme for merger and/ or any arrangement should be approved by a majority in number representing also 3/4th in value of shareholders/creditors present and voting. The requirement of majority in number does not serve any useful purpose considering that value is simultaneously being considered as a criterion. Besides, international practice recognizes value as the determining factor and does not appear to impose such additional conditions. The Committee is, therefore, of the view that this requirement, in Indian law, may also be modified to provide only for approval by 3/4th in value of shareholders and creditors, present and voting.
2. Under the present scheme of Act, the manner of holding of the meetings of the creditors and shareholders as also dispensing with the same is left to the discretion of the courts. However,

[40] http://www.mca.gov.in/MinistryV2/mergers+and+acquisitions.html

different courts follow different procedures. The Committee feels that there is a need for uniformity in this regard and recommends that rules may be formulated under the Act to cover this aspect, including dispensing of the requirement to hold such meetings.

Minority Interest

1. The Committee examined the view that quite frequently shareholders/creditors with insignificant stake raise objections to schemes of merger/acquisition and the process of dealing with such objection becomes vexatious. After a detailed discussion, the Committee recommended that while protection of minority interest should be recognized under the law, only shareholders/creditors having significant stake at a level to be prescribed under law should have the right to object to any scheme of mergers. The philosophy behind such a move would be to streamline the procedure of articulation of the minority interest while restricting obstructionist attitude on the part of any section of minority.[41]

Merger of class of Companies

1. The Committee reviewed the international models of mergers and amalgamations. In the case of mergers within a group, the Act may prescribe a short form of amalgamation. Conceptually a scheme of amalgamation or merger between holding company and subsidiary company stands on a different footing from amalgamation and merger between two independent companies. So also, merger between two private limited companies should be viewed differently as compared to the merger of two public limited companies.
2. The amended new Act should provide for less regulation in respect of mergers among associate companies/two private limited companies where no public interest is involved. The concept of contractual merger should also be thought of as an alternative to the form of merger available under the Act as on date.

Cross Border Mergers

1. A forward-looking law on mergers and amalgamations needs to also recognize that an Indian company ought to be permitted with a foreign company to merger. Both contract-based mergers

[41] http://www.mca.gov.in/MinistryV2/mergers+and+acquisitions.html

between an Indian company and a foreign company and court based mergers between such entities where the foreign company is the transferee, needs to be recognized in Indian Law. The Committee recognizes that this would require some pioneering work between various jurisdictions in which such mergers and acquisitions are being executed/created.

2. The Indian shareholders should be permitted to receive Indian Depository Receipts (IDR) in lieu of Indian shares especially in listed companies or foreign securities in lieu of Indian shares so that they become members of the foreign company or holders of security with a trading right in India (especially in listed companies). Further, in such cases, the shell of such company should be allowed to be dissolved without winding up with court intervention. The present Act does not permit this form of merger in view of the specific definition of company under section 390(a) of the Companies Act. The Committee noted that apart from amendments to the Companies Act, suitable changes may be necessary in the Income Tax Act, Foreign Exchange Management Act and provisions relating to IDR to enable merger of an Indian Company with foreign entity. The Committee therefore recommended adoption of international best practices and a coordinated approach while bringing amendments to the code of merger in the Companies Act.[42]

Disclosure Requirements:

1. As the shareholders need to have complete information in the case of a scheme of merger/acquisition, especially in the case of promoter-initiated mergers, the Act/Rules should list out the disclosure requirements in the explanatory statements to be sent to the shareholders in respect of the scheme filed before the Courts/Tribunals. In the case of Companies required to appoint independent directors, the Act should mandate the Committee of independent directors as a monitoring body to ensure adequacy of disclosures.

Corporate Debt Restructuring

1. The Reserve Bank of India has specific tools for fast-track debt restructuring known as the CDR Mechanism (Corporate Debt Restructuring Mechanism). It is often seen that sometimes even though 75% of the secured creditors consent to the debt restructuring and make significant

[42] http://www.mca.gov.in/MinistryV2/mergers+and+acquisitions.html

sacrifices, minority secured creditors or unsecured creditors put a spoke through the wheel. As a result, such schemes that would otherwise enable the return of the corporate to viable operation, get delayed or scuttled.

2. As in the case of contractual mergers or schemes of arrangement, the Committee recommends that if the petitioning creditors or petitioning company is prima facie able to prove that 75% of the secured creditors who have consented to the CDR Mechanism have made sacrifices to restructure the company then, notwithstanding the minority dissent, such a scheme should be sanctioned on filing.
3. Appropriate remedies for misstatement and the ability to revoke such an order with punishment for any misstatement would be an adequate safeguard for false misstatement. The unsecured creditors are subsequent in the queue and without the consent of the secured creditors and their debt restructuring, they would have no hope to receive their dues. However, to safeguard their interests and to ensure the continuity of the company's functioning, the scheme must satisfy a minimum liquidity test and should have provisions for a security pool either made available by the secured creditor as cash availability or by the promoter to progress the scheme of restructuring.
4. Such schemes must contain safeguards against fraudulent preference and must have a creditors' responsibility statement, similar to a directors' responsibility statement, appended to it. Withdrawal from the security pool provided for by the liquidity test could be regulated by the Court/ National Company Law Tribunal.
5. The Committee recommended that the need to file a separate scheme for reduction of capital simultaneously the scheme for merger and acquisition should be avoided. The provisions relating to obtaining consent from unsecured creditors should be done away with. To ensure continuity of the existence of transferee company/resulting company, the Committee felt the need to mandate requirement of a satisfactory liquidity test and prescribed debt equity norms. The creditors consent may be necessary only in case of companies not meeting the liquidity test.

Amalgamation in public interest

1. Existing Section 396 empowers Central Government to order amalgamation of two or more companies in public interest. It has been suggested that these provisions should be reviewed. It

is felt that amalgamation should be allowed only through a process overseen by the Courts/Tribunals. Therefore, instead of existing provisions of Section 396, provision should be made to empower Central Government to approach the Court/Tribunal for approval for amalgamation of two or more companies. Fees on Increased Authorized Share Capital

2. At any point of time the transferor company and the transferee company, both companies would have paid fees of their respective authorized share capital at the rates specified in Schedule X of the Companies Act, 1956. Upon dissolution of the transferor company into the transferee company, the fees paid by the transferor company go waste and the transferee company gets no set off for the same.
3. In order to facilitate and encourage merger and acquisition activities, it is recommended that the fees paid by the transferor company on the authorized share capital should be available as a set off to the transferee company upon the sanction of the scheme of amalgamation by the High Court. This principle should apply both in respect of merger and demerger cases.

Introduction of Non-Obstante Clause in Section 394(2)

1. Section 394(2) of the Companies Act, 1956 provides for vesting of assets and liabilities of the transferor company in the transferee company upon the sanction of the scheme of amalgamation by the High Court. Since the section does not contain a non-obstante clause, it creates immense practical difficulties in actual transfer of the various properties/assets of the transferor company into the transferee company.
2. It was noted that the Sick Industrial Companies (Special Provisions) Act, 1985 and Section 32 thereof had clear provisions in the nature of a non-obstante declaratory order whilst sanctioning a scheme of restructuring.

The Sick Industrial Companies Act has been subsumed in the company law and the principles therein, therefore, are eminently capable of being modified and applied in the new company law to be made.

3. It is therefore recommended that a non-obstante provision be introduced in the relevant provisions of the law to ensure that the assets and liabilities of the transferor company absolutely vest in the transferee company notwithstanding anything to the contrary in any other law for the time being in force. This would ensure that the transferee company is not subjected to cumbersome formalities for the transfer of assets and liabilities in its own name.

7.2 THE PROCEDURE OF MERGER

Companies Act 2013 provides fast-track procedure for the merger. The procedure is as under:

- Both the transferor and transferee shall convene the Board meeting separately and pass the following resolutions:
  - Approving the scheme.
  - Fixing date, time and place for Shareholders Meeting.
  - Fixing date, time and place for Creditors Meeting.
- After holding the Board Meeting both the Transferor Company and the transferee company shall publish the notice of the proposed scheme to invite any objections or suggestions regarding the same. The copy of the notice shall be sent to the Registrar of Companies and the Official Liquidator.
- Before convening the meeting of members and creditors both the transferor and transferee company shall file with the ROC of their state where their registered office has situated a declaration of solvency.
- A notice of a meeting of members should be given at least 21 clear days before the meeting by both the transferor and the transferee company. The notice of the meeting shall contain the following:
  - Details of compromise and arrangement.
  - Declaration of insolvency.
  - Copy of scheme.
- The objections received shall be considered and discussed at the general meeting and will be approved by the members of both the companies.
- After convening the meeting of members, a notice of creditors shall be given at least 21 clear days before the meeting by both the transferor and transferee company. The scheme of the merger to be executed has to be approved by the creditors representing $9/10^{th}$ in value.
- The transferee company shall within seven days of the conclusion of the meeting of members file a result of a meeting of members with the Regional Director, Registrar of Companies and

Official Liquidator.

- After the scheme is filed and the Registrar and the Official Liquidator does not have any objections the Regional Director shall register the same and will give a confirmation regarding the same.
- If there is some kind of objection to the Registrar or Official Liquidator, they shall communicate the same to the Regional Director within the period of 30 days.
- After the RD receives the objection by the Liquidator or Registrar and is of the opinion that the scheme is not in public interest or in the interest of creditors, he shall within the period of 60days communicate the same to the tribunal and request to consider the same.
- If the Tribunal is of the opinion that the scheme is appropriate it shall pass the order that the procedure given in Section 232 shall be followed. The order of the tribunal should be given in writing.
- If the scheme is approved by the Regional Director, then both the transferor and the transferee company shall within the period of 30 days from the date of confirmation of the scheme file the confirmation order with the ROC where the registered office of the transferee Company is situated, he shall register the same and give a confirmation letter regarding the same that confirmation letter is filed with the ROC of the Transferor Company.

7.3 THE PROCEDURE OF ACQUISITION[43]

1. Researching Target Companies:

Before acquiring any company, a detailed research about the company is necessary which will avoid the problems in future. A matrix of the company should be made regarding the profitability, cash flow, growth rate etc. Research should be done through various sources.

2. Initial Contact:

After the research have been completed the acquiring company should contact the target company so that many issues can be clarified which would take place in the future. Contact can be made through following ways:

Discrete contact: In this type direct contact is made with the owner of the target company.

[43] https://enterslice.com/learning/merger-acquisition-process-india/

This process can take several days or months. It is not necessary that it may affect the immediate acquisition.

Joint Venture: It is one of the best methods to enter into a joint venture agreement with the target company. This agreement will give detailed information about the company's activity and operational detail. This detailed information will help the acquirer to deal with the target company.

Third party: There may be situations when the target company does not want to give any information to any other company regarding its business, In this case the acquirer company can appoint investment banker who will work on the behalf of the acquirer company in taking general enquiries of the target company regarding the willingness of the owner about the acquisition.

3. Non- Disclosure Agreements:

This agreement is entered between the Acquirer Company and the Target Company. This agreement can be entered only after the target company has approved the offer of acquisition. In this agreement, it is stated that all the documents or information disclosed by the target company to the acquirer company shall remain confidential and will not be disclosed to anyone. However, this agreement is difficult is to enforce but on the other hand, it is necessary to be entered.

4. Letter of Intent:

As soon as the acquirer company and the target company sign the Non-Disclosure Agreement the target company will transfer all the documents, historical background and detailed information to the acquirer company based on which the acquirer company can take the decision to whether proceed with the deal or not.

5. Due Diligence:

In this step, the acquirer company shall give a list of due diligence to the target company. This process may take a considerable amount of time as the documents may not be easily available with the target company as it may not be prepared for selling itself. Audited financial statements will help a lot as it will depict the true financial position of the company.

6. Final Negotiations:

After the due diligence has been completed it may be possible that the acquirer company may be in a position to do bargaining or negotiation in relation to the price demanded by the target company for the acquisition. As the process of due diligence will help in finding any major issues which will help in bargaining.

7.4 REASON BEHIND MERGER & ACQUISITION

There are a number of reasons that mergers and acquisitions occur. These issues generally relate to business concerns such as competition, efficiency, marketing, product, resource, and tax issues. They can also occur because of some very personal reasons such as retirement and family concerns. However, let's begin our exploration of why corporate combinations occur by discussing an often-cited reason - corporate greed.

Corporate Greed

Some people say that mergers and acquisitions occur because the greedy corporations want to acquire everything. As far as economic theory is concerned, the primary objective of a firm is to maximize profits, and thereby maximize shareholder wealth.

When evaluating a new company, it becomes very important to identify the answers to various questions concerning motives for merger and whether it has been actualized. On the other hand, investors need to know if the new entity would take them to the heights of capital markets where their aspirations regarding returns would get the wings and fire.

Some of the motives for mergers are as below:

Synergy

Synergically effect occurs when two substances or factors combine to produce a greater effect together than the sum of those together operating independently. The principle of 2+2 =5, this theory expects that there is really "something out there which creates the merged entity to maximize the shareholders' value". To put in other words, synergy is the ability of a merged company to create more shareholders value than standalone entity.

Financial synergy

The resultant feature of corporate merger or acquisition on the cost of capital of the combined or acquiring firm is called as financial synergy. It occurs as a result of the lower cost of internal financing versus external. A combination of firms with different cash flow positions and investment scenario may produce the synergic effect and achieve lower cost of capital. It means when the rate of cash flow of the acquirer firm is greater than that of the acquired firm, there is tendency to relocate the capital to the

acquired firm and the investment opportunity of the latter increases. If the cash flows of the two entities are not perfectly correlated, the financial synergy can be expected thus reducing risk. The perceived reduction of the instability of the cash flow, would lead the suppliers to trust the firm, the combined debt capacity of the combined firm may be greater than the individual firms.

Operating synergy

Economies of scale and economies of scope exist in the industry and before the merger, the activities of the individual firms are insufficient to exploit these.

Synergy takes the form of revenue enhancement and cost reduction. Speaking of cutting down costs, this goal is typically achieved through economies of scale, particularly when it comes to sales and marketing, administrative, operating, and/or research and development costs. As for revenue synergies, these are achieved through product cross-selling, higher prices due to less competition, or staking a larger market share.

The merger of ICICI with ICICI Bank and the reverse merger of IDBI Bank with IDBI served multiple objectives. First, the institutions were strengthened financially. Second, they helped to avoid the complex processes of restructuring the weaker of the units and to foster financial stability. Finally, they have opened the possibilities of actively promoting universal banking. When two companies in the same industry merge, the combined revenue tends to decline to the extend, they overlap with one another and some of the customers may also become alienated. For the merger to benefit the shareholders, there must be ample opportunities for the cost reduction, so that the initial lost value is recovered in due course through synergy.

To calculate the minimum value of the synergy required, to compensate the acquiring firm's shareholders, we equate the post-merger share price with that of the pre-merger share price using the following:

(Pre-merger value of both the firms + synergies)/ Post merger number of shares = Pre- merger stock price

Growth

Increasing a company's growth is the most common reason behind merger. Growth can be achieved through investing in capital projects internally or externally by buying out the assets of outside companies. Empirical studies show that the faster growth rates are achieved through external growth

by means of mergers and acquisitions.

Merging internationally provides an immediate growth opportunity to a firm which was once operating within a single country. There are various factors which encourage a firm to merge internationally for growth are:

1. A firm with surplus cash flows operating in a slow-growing economy can invest its cash in fast-growing economy.
2. The domestic markets if are too small to accommodate the corporate or if the domestic markets have already reached saturation can go for international markets.
3. Overseas expansion may sometimes enable the medium size companies to improve their capacity and ability to compete.
4. Size enables the companies to achieve the economies of scale.

In September 2002, Asian Paints India Ltd, announced its decision to acquire 50. 1 % controlling stake in the Singapore-based Berger International Ltd for a consideration of Rs. 57. 6 crores. The primary reason for the merger was to enter into the South-East Asian market that BIL offered. With this acquisition, Asian paints would have a combined capacity of about 100,000 tones and will have 27 manufacturing facilities worldwide.

Market Power

One of the main motives of a merger is to increase the share of a firm in the market. It means to increase the size of the firm and also leading to the monopoly power; hence the firm gets an opportunity to set prices at levels that are not sustainable in a more competitive market. There are three sources by which market power can be achieved. They are product differentiation, overcoming entry barriers and improving market share.

One important reason that companies combine is to eliminate competition. Acquiring a competitor is an excellent way to improve a firm's position in the marketplace. It reduces competition, and allows the acquiring firm to use the target's resources and expertise. Unfortunately, combining for this purpose is *per se* illegal under the antitrust acts as a predatory practice in restraint of trade. Consequently, whenever a merger is proposed, a major part of the resulting press release often deals with how this combination of firms is not anti- competitive, and is done to better serve the consumer. Even if the merger is not for the stated purpose of eliminating competition, the regulatory agencies may conclude

that a merger is likely to be anti-competitive. For example, Canadian National's attempt to merge with Burlington Northern Santa Fe was blocked because of concerns that the combination would prompt a series of mergers and acquisitions whose net effect would be to leave the continent with only two transcontinental railroads. Although eliminating competition may result in merger and acquisition activity, it is generally not acceptable to state this as the purpose of such activity.

Horizontal mergers which take place with a motive to attain market power. It is of great concern to the government because, it might lead to concentration or monopoly. Hence comparison between their efficiencies versus their effects of increased concentration must be made. Note that horizontal mergers are not the only type of mergers that can yield more market power. Vertical mergers can enable a company to capture sources of supplies, for example, that are of paramount importance to its competitors. This is why industry regulators routinely limit and even disallow horizontal and vertical mergers if there is even a hint of too much market power concentrating in the hands of only a few companies.

Corporate Tax Savings

Although tax savings may not be a primary motivation for a combination, it can sweeten the deal. When a purchase of either the assets or common stock of a company takes place, the tender offer less the stock's purchase price represents a gain to the target company's shareholders. Consequently, the target firm's shareholders will usually experience a taxable gain. However, the acquiring company may reap tax savings depending on the market value of the target company's assets when compared to the purchase price. The acquiring company can write up the target company's assets by the amount that the market value exceeds the net book value of the target company's assets. This difference can then be charged off to depreciation with resultant tax savings. This differs from goodwill in that goodwill is never tax deductible. Depending on the method of corporate combination, further tax savings may accrue to the owners of the target company.

Retirement or Cashing Out

For a family-owned business, when the owners wish to retire, or otherwise leave the business, and the next generation is uninterested in the business, the owners may decide to sell to another firm. For purposes of retirement or cashing out, if the deal is structured correctly, there can be significant tax

savings. By using the pooling method, the sellers may be able to account for their sale of their interest as a tax-free exchange. Provided the sellers receive common stock of the purchasing company in exchange for their interest, they can assign the book value of their former investment to the shares received. Therefore, no tax would be due until the shares received are sold.

Other tax incentives

If a firm having operating losses merges with another firm which has taxable profits, then there will be a net gain to the acquiring firm often at the expense of the government. The losses can be used to reduce the taxable income**.** Even if the two firms, which have merged have current profits, a merger can reduce future tax liability as the variability of cash flows is lowered after the merger. One firm's profit can be off-set by other firm's losses thus resulting in tax savings. Smaller the correlation between the firm's cash flows, larger is this effect.

Market/Business/Product Line Issues

Often mergers occur simply because one firm is in a market that another wants to enter. All of the target firm's experience and resources (the employees' expertise, business relationships, etc.) are available by buying the targeted firm. This is a very common reason for acquisitions. For example, Monsanto acquired G. D. Searle because Monsanto wanted to acquire the pharmaceuticals and consumer chemicals (Aspartame) businesses. Sentry Insurance acquired John Deere Insurance Group to enter the market for insuring implement dealers, and transportation. CSK Automotive purchased All-Car to have access to the Central Wisconsin automotive parts market. Similarly, Canadian National purchased Wisconsin Central to enter the U. S. rail market. Whether the market is a new product, a business line, or a geographical region, market entry or expansion is a powerful reason for a merger.

Closely related to these issues are product line issues. A firm may wish to expand, balance, fill out or diversify its product lines. For example, merger and acquisition activities of Nortek/Peachtree Companies are primarily product line related.

Acquire Needed Resources

One firm may simply wish to purchase the resources of another firm or to combine the resources of the two firms. These resources may be tangible resources such a plant and equipment, or they may be

intangible resources such as trade secrets, patents, copyrights, leases, etc., or they may be talents of the target company's employees. One reason given for the mergers in the petroleum industry is that companies wish to acquire the leases of their competitors. If acquiring a company for its talent seems strange, consider that Cisco Systems CEO John T. Chambers said, "Most people forget that in a high-tech acquisition, you are really only acquiring people. We are not acquiring current market share. We are acquiring futures". It emphasizes that often the reasons for mergers and acquisitions are quite similar to the reasons for buying any asset. Both firms and individuals purchase an asset for its utility.

Diversification: Diversification is another frequently cited reason for mergers. Actually, it was the reason during the conglomerate merger wave. The idea was to circumvent regulatory restrictions on horizontal and vertical mergers by going outside a company's industry into new markets and to achieve growth there.

International mergers provide diversification both geographically and also by product line. When various economies are not correlated, then the international mergers reduce the earning risk, inherent in being dependent on a single economy. Thus, international mergers reduce systematic and unsystematic risk.

7. 5 CASE LAWS IN RELATION TO MERGERS

- **Hindustan Lever Employees' Union Vs. Hindustan Lever Limited and others[44] Facts:**

Appeals challenging amalgamation of two companies’ 'K' and 'L' by employee’s union appellant contended that amalgamation made in violation of provisions of Act of 1969 and exchange ratio of shares grossly loaded in favour of 'K' and interest of employees were not taken care.

Judgment and Ratio:

Supreme Court found no irregularity in exchange ratio of shares - explanatory note justified on face of it as no complaint made by any concerned financial institution - no material placed before Court to prove infringement of interests of employees - infringement does not result automatically from amalgamation of companies - unless some illegality of fraud involved in scheme Court cannot decline to sanction merger under Act of 1969 merger could not be prohibited simply because large share of market would be captured by 'K' amalgamation valid and justified - appeal dismissed.

[44] AIR1995SC470

- **Miheer H. Mafatlal Vs. Mafatlal Industries Ltd.[45]Facts:**

Company in amalgamation – Sections 391, 392, 393, 394A, 433 and 643 of Companies Act, 1956 – whether scheme of amalgamation is prejudicial to interests of minority shareholders – scope of Company Court to sanction scheme of amalgamation is limited – Court can intervene in matter only when it is not just and fair or prejudicial to interest of shareholders.

Judgment and ratio:

Court cannot intervene if scheme is sanctioned by majority of shareholders and is lawful Court can only go through scheme and examine whether it has complied requirements under **Section 391 (2**) and was passed by requisite majority or not – scheme passed by company with majority is just and fair and no minority interest is affected – individual personal interest of minority shareholders is of no concern unless it is affecting class interest of such equity shareholders – no requirement as to before putting scheme to vote meeting of minority shareholders has to be convened – appeal dismissed.

- **Tata Motors Ltd. Vs. Pharmaceutical Products of India Ltd. and Anr. Facts:**

Company Winding up of company Interpretation/ application of the provisions of the Sick Industrial Companies (Special provisions) Act, 1984 (SICA) vis-`-vis the Companies Act, 1956 Held, the provisions of a special Act will override the provisions of a general Act A later of it will override an earlier Act 1956 Companies Act is a general Act and it is prior in point of time to SICA therefore, provisions of SICA will have an overriding effect over provisions of Companies Act in case of conflict Company Winding up of company Jurisdiction of civil Courts in company matters Held, SICA seeks to give effect to the larger public interest therefore, it should be given primacy over Companies Act because of its higher public purpose Section 26 of SICA bars the jurisdiction of the civil Courts The jurisdiction of civil court is, thus, barred in respect of any matter for which the appellate authority or the Board is empowered

Some Other Cases: -

[45] AIR1997SC506

In the central *India Industries Ltd. vs. C.I.T.*[46] , It was held that amalgamation is an arrangement whereby the assets of two companies become vested in or under the control of one of the original two companies, which has its shareholders all or substantially all the shareholders of the two companies.

In *General Radio vs. M.A.Khader Supreme Court* held[47], that after amalgamation, transfers company doesn't become tenant of premises, even if tenancy rights are transferred to transferee company.

In *United Breweries vs. Commission of Excise*[48] It was held that there exist 'transfer even if shareholders are same, as transferor company ceases to exist after amalgamation.

In *Marshall Sons and Co. (India) Ltd., vs. Income Tax Officer*[49], Supreme Court held that every scheme has to provide a date with effect from which amalgamation shall take place. While sanctioning the scheme it is open to National Company law Tribunal to modify the said date and prescribe such date of amalgamation as it thinks appropriate in the facts and circumstances of the case.

In *C.I.T. vs. Bombay Dyeing and Mfg. Co. Ltd*[50], In this case expenditure on professional charges of solicitors in connections with amalgamation is allowable business expenditure in light of finding that amalgamation was necessary for smooth and efficient conduct of business.

In *Sadanand S.Varde vs. State of Maharashtra*[51] , Bombay High Court held that the Court cannot sit in Judgement over the correctness of on order made under section 391 by Company Court which has become final, conclusive and binding.

In *Awsys Software Private Ltd.*, [52]Karnataka High Court held that section 391 and 394 required holding

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[46] (1975) 99 ITR 211.
[47] AIR 1986 SC, 1218.
[48] (2002) 36 SCL 641

[49] (1995) 223 ITR 809
[50] (1996) 219 ITR 521.
[51] (2001) 30 SCL 268 (Bom)

[52](2004) 122 Comp. Case 526 (Kar)

of meeting of the members and creditors for the purpose of discussing and approving a proposed scheme, it has a definite purpose and object that couldn't be done away which is in conflict with very provisions of law.

In *Blue Star Ltd.* [53]In.re.[120] Bombay High Court held that transfer of shares by one company to another company is primarily to be determined by shareholders and if over whelming majority considers it fair and reasonable then Court should not interfere with it.

It is a case Judged by Supreme Court of India, *Hindustan lever vs. State, National Capital Territory, Delhi*[54], In a Scheme of Amalgamation filed with the High Court, eighteen wholly owned subsidiaries engaged in the business of real estate, proposed to merge with their parent company 'Delhi Towers Limited'. The scheme became effective after being approved by the High Court under provisions of section 394 of the companies Act. Pursuant to the sanction of the scheme by High Court, the Petitioner made an application to the local Authorities of the Government of National Capital Territory of Delhi having Jurisdiction over the properties of Transferor companies to effect mutation of the same in its records in favour of the Petitioner. Despite repeated request Local Authority of Government of NCT of Delhi refused to affect the mutation of the properties in favour of the Petitioner under the Scheme, stating that the stamping authorities did not accept the scheme without payment of stamp duty thereon. Now the question before Court is whether upon sanction of scheme by High Court, the property is transferred by operations of law?

So, Supreme Court decided that a scheme of Amalgamation transferring assets and liabilities in favour of the transferee company would be regarded as an instrument, which is subject to payment of stamp duty. The Judgement would imply an additional stamp duty on the scheme of amalgamation / merger, which is to be calculated on the basis of shares exchange ratio between the transferor company and the transferee company and not solely on the basis of the assets and liabilities to be transferred under such scheme.

[53] (2001), 104 Comp. Case 371 (Bom) Larsen and Tourbo Limited, Inre (2004) 121 Comp. Case. 523
[54] Case decided in July 2010, taken from http://yedhulaprakash1.lawers clubindia.com/judiciary/court approved scheme.

In *Kashinat Dikshit vs. Surgicals and Pharmaceuticals in Liquidation*,[55]Karnataka High Court held that any other person except any creditor or any company member or if company is wound up by liquidator of the company under section 391 (1) would not be entitled to move application for the scheme of amalgamation.

In re *Hindalco Industries Ltd*.[56], Whether a person who is neither a shareholder nor a creditor has no locus standi to raise objection in relation to a scheme propounded by such company under sec. 391. Interveners have no locus standi in proceedings.

In *Sriniwas Giri Kamgar Kruti Samiti and others vs. Rangnath Basudev Somani and others*[57] Bombay High Court held that once the court is satisfied that all the statutory proceedings has been followed and that majority decision was Just and fair, it is not permissible for Court to permit third party to Intervene. The interveners could not be allowed to intervene in the public Interest as they were neither shareholders nor creditors of company. Thus, they will have no locus standi in the proceedings under sections 391 and 393.

In *Vishnu Barium Chemicals Pvt. Ltd.*[58]*,* In re, Andhra Pradesh High Court also held that where the majority of parties agree for the variation in the contract terms the court is authorized to impose such variation even on the remaining dissenting members, but where set of class of creditors does not agree for proposal, it is the duty of Court to examine whether consent is unreasonable withheld or alternatively whether sanction of scheme would prejudicially effect that set of creditors who have withheld the consent.

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[55] (2002) 40 SCL 921 (Kar) ; S.K.Gupta K.P.Jain (1979) 49 Comp Case 342 (S.C)

[56] (2009) 94 SCL, 1 Bom

[57] (2005) 127 Comp Case 752 (Bom) ; Hindustan Lever vs. State of Maharashtra (2003) 117 Comp Case 758 ; J.K (Bombay Pvt. (TD). New Kaiser, AIR 1970 SC 1041 company.

[58] (2002)110 Comp. Case 67 (AP)

CONCLUSION & SUGGESTIONS

With the FDI policies becoming more liberalized, Mergers, Acquisitions and alliance talks are heating up in India and are growing with an ever-increasing cadence. They are no more limited to one particular type of business. The list of past and anticipated mergers covers every size and variety of business -- mergers are on the increase over the whole marketplace, providing platforms for the small companies being acquired by bigger ones. The basic reason behind mergers and acquisitions is that organizations merge and form a single entity to achieve economies of scale, widen their reach, acquire strategic skills, and gain competitive advantage. In simple terminology, mergers are considered as an important tool by companies for purpose of expanding their operation and increasing their profits, which in façade depends on the kind of companies being merged. Indian markets have witnessed burgeoning trend in mergers which may be due to business consolidation by large industrial houses, consolidation of business by multinationals operating in India, increasing competition against imports and acquisition activities. Therefore, it is ripe time for business houses and corporates to watch the Indian market, and grab the opportunity.

In real terms, the rationale behind mergers and acquisitions is that the two companies are more valuable, profitable than individual companies and that the shareholder value is also over and above that of the sum of the two companies. Despite negative studies and resistance from the economists, M&A's continue to be an important tool behind growth of a company. Reason being, the expansion is not limited by internal resources, no drain on working capital - can use exchange of stocks, is attractive as tax benefit and above all can consolidate industry - increase firm's market power.

With the FDI policies becoming more liberalized, Mergers, Acquisitions and alliance talks are heating up in India and are growing with an ever-increasing cadence. They are no more limited to one particular type of business. The list of past and anticipated mergers covers every size and variety of business -- mergers are on the increase over the whole marketplace, providing platforms for the small companies being acquired by bigger ones.

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