

# Mergers-What, Why & When

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ADVOCATES AND SOLICITORS

## Amalgamation:

- When two or more companies carrying on similar business decide to combine, a new company is formed to take over their business.
- Blending of two or more existing undertakings into one undertaking, the shareholders of each blending company becoming substantially the shareholders in company which is to carry on the blended undertakings.
- Either by transfer of two or more undertakings to a new company or by the transfer of one or more undertakings to an existing company.

## Merger:

- A merger is a corporate strategy of combining different companies into a single company in order to enhance the financial and operational strengths of both organizations.

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# Types of Mergers or Amalgamation

- ▶ Involves combining two companies into a single larger company.
- ▶ The combination of the two companies involves a transfer of ownership, either through a stock swap or a cash payment between the two companies.
- ▶ In practice, both companies surrender their stock and issue new stock as a new company.
- ▶ Horizontal combination:
  - ▶ This is a merger of two competing firms belonging to the same industry which are at the same stage of the industrial process.
  - ▶ It is also an indirect route to achieving technical economies of a large scale.
  - ▶ These mergers are carried out to obtain economies of scale in:
    - ▶ production by eliminating duplication of facilities and operation and broadening the product line;

# Types of Mergers or Amalgamation

- ▶ reducing investment in working capital, eliminating competition through product concentration;
- ▶ reducing advertising costs, increasing market segments and exercising a better control over the market.
- ▶ Vertical combination:
  - ▶ A company takes over or seeks a merger with another company in order to ensure backward integration or assimilation of the source of supply or forward integration towards market outlets.
  - ▶ The acquirer company gains a strong position due to the imperfect market of its intermediary products and also through control over product specifications.

# Types of Mergers or Amalgamation

- ▶ **Conglomerate Mergers:**
- ▶ is in amalgamation of two companies engaged in unrelated industries.
- ▶ It enhances the overall stability of the acquired company and improves the balance in the company's total portfolio,
- ▶ resources of the conglomerate which result in technical efficiency and furthermore it could have access to the greater financial strength of the present acquirer which provides a financial basis for further expansion by acquiring potential competition.
- ▶ **Within Group Mergers:**
- ▶ when the subsidiary company merges with the parent company or vice-versa. The former arrangement is called downstream and the latter is called the upstream merger.

# Reasons and Motives for Amalgamation

- ▶ To achieve certain strategic and financial objectives. The collective finances of merged companies will be more and their utilisation may be better than in the separate concerns.
- ▶ shareholder wealth maximization; The shareholder wealth maximised criterion is satisfied when the added value created by acquisition exceeds the cost of acquisition.
- ▶ managerial and Key personnel utility;
- ▶ To achieve economies of scale: This generally refers to a method in which the average cost per unit is decreased through increased production. More intensive utilisation of production facilities, distribution network, research and development facilities.
- ▶ To achieve increased revenue / Increased Market share: This motive assumes that the company will be absorbing the major competitor and thus increase it's to set prices.
- ▶ Cross selling: For example, a bank buying a stock broker can sign up the bank' customers for brokerage account.
- ▶ To achieve corporate synergy: Better use of complimentary resources. It may take the form of revenue enhancement and cost savings. Duplicating facilities in accounting, purchasing, marketing, etc. will be eliminated.

# Reasons, Why & When for Amalgamation

- ▶ To achieve geographical or other diversification: This is designed to smoothen the earning results of a company, which over the long term smoothen the stock price of the company giving conservative investors more confidence in investing in the company.
- ▶ Investment made by the shareholders in the companies subject to merger should enhance in value. Shareholders may gain from mergers in different ways viz. from the gains and achievements of the company through:
  - ▶ -Realization of monopoly profits ;
  - ▶ -Diversification of product line; and
  - ▶ -Better investment opportunities in combination.

# Reasons and Motives for Amalgamation

- ▶ To achieve inorganic Growth: A company may not grow rapidly through internal expansion. Merger or amalgamation enables satisfactory and balanced growth of a company. A number of costs and risks of expansion and taking on new product lines are avoided by the acquisition of a going concern.
- ▶ Utilization of Tax Benefits: When a company with accumulated losses merges with a profit making company it is able to utilise tax shields. A company having losses will not be able to set off losses against future profits, because it is not a profit earning unit.
- ▶ On the other hand if it merges with a concern earning profits then the accumulated losses of one unit will be set off against the future profits of the other unit. In this way the merger or amalgamation will enable the concern to avail tax benefits.

# Reasons and Motives for Amalgamation

- ▶ Increase in value of the merged company: The value of the merged company is greater than the sum of the independent values of the merged companies. For example, if X Ltd. and Y Ltd. merge and form Z Ltd., the value of Z Ltd. is expected to be greater than the sum of the independent values of X Ltd. and Y Ltd.
- ▶ Eliminate competition among them. companies will be able to save their advertising expenses thus enabling them to reduce their prices. The consumers will also benefit in the form of cheap or goods being made available to them.



# Reasons, Why & When for Amalgamation

- ▶ **From the Standpoint of Managers :**
- ▶ **relation between shareholders and the managers is equivalent to that of principle and agents may not always act in the best interests of their principal.**
- ▶ **The cost to the shareholders of such behavior is called the agency cost representing loss of value to the shareholder. Thus the managers act in disregard to their principles promoting their own self-interest.**
- ▶ **To pursue growth in size of their firm, since their remuneration status, prerequisites and power are functions of firm size (the empire building syndrome).**
- ▶ **Managers' compensation can be interrelated to firm size because it creates complexity of large firms.**
- ▶ **Managers may derive intangible benefits such as power and social statues when they run large firms.**
- ▶ **To deploy their currently underused managerial talents and skills.**

# Reasons...Trade and other advantages:

- ▶ Diversification and expansion - merger and acquisition are motivated with the objectives to diversify the activities so as to avoid putting all eggs in one basket and obtain advantage of joining the resources for the enhanced debt, the financing, and the better service ability to shareholders.
- ▶ Taxation advantage - a company may find it beneficial to accumulated losses for having benefits of tax laws that will shield income from taxation. Section 72A of Income Tax Act 1961 provides this incentive for reverse mergers for the survival of the sick units.
- ▶ Vertical integration - it is profitable for a company to amalgamate with another company which supplies it with raw material and channels its products into market. Fusion of such two companies leads to reduction of overheads and thus creates trade advantage.

# Reasons...

- ▶ Production capacity reduction - amalgamation of two units manufacturing or dealing in the same product may lead to reducing the cost of research, production, advertisement and sale.
- ▶ Purchase of management/growth advantage - the merger and acquisition are motivated with a view to sustain growth. To develop new areas becomes costly, risky and difficult than to acquire a company in the growth sector even though acquisition is on premium rather than investing in new assets.
- ▶ Financial advantage - companies functioning in the same group are treated more favourable by its financiers. Thus a company outside the group and facing difficulty in obtaining finance may be likely to join the group and thereby solve its tight financial position.

# Reasons...

- ▶ A sick unit may be required to merge with a healthy unit to ensure better utilisation of resources, improve returns and better management;
- ▶ Insolvency & Bankruptcy related reasons;
- ▶ Combination of Authorised Share Capital;
- ▶ Reduction & Reorganization of Capital;
- ▶ Buyback of shares;
- ▶ Squeezing of Minority Shareholders or dissenting ones;
- ▶ Accounting, Trimming/cleaning of Balance sheet;
- ▶ Others

# Reasons... Synergies.

**Revenue Synergy:**

**Cost Synergy:**

**Financial Synergy:**

# Revenue Synergy:

- ▶ If two companies go through revenue synergy, they happen to sell more products.
- ▶ For example, let's say that A Co. has acquired B Co. A Co. has been in the business of selling 'X' detergent. B Co. is not a direct competitor of A Co. But B Co. sells 'Y' detergent at quite cheaper rates. B Co. is still very small in profit and size, but they have been giving a competition to A Co. since it is selling 'Y' detergent at a much lesser price.
- ▶ As A Co. has acquired B Co., A Co. has increased its territory from selling only 'X' detergent to selling 'Y' detergent in a new market. By going through this acquisition, the revenue of both of these companies will increase and they would be able to generate more revenue together compared to what they could have done individually. This is the significance of Revenue Synergy.

# Cost Synergy:

- ▶ Cost synergy allows two companies to reduce costs as a result of the M&A.
- ▶ If we take the same example, we took above; we would see that as a result of the acquisition of B Co., A Co. is able to reduce the costs of going to a new territory. Plus, A Co. is able to get access to a new segment of customers without incurring any additional cost.
- ▶ Cost reduction is one of the most important benefits of cost synergy. In the case cost synergy, the rate of revenue may not increase; but the costs would definitely get reduced. In this example, when the cost synergy happens between A Co. and B Co., the combined company is able to save a lot of costs on logistics, storage, marketing expenses, and also in R&D. Hence cost synergy is quite effective when the right companies enters into M&As together or one company acquires another.

# Financial Synergy:

- ▶ Financial synergy is usually seen when two mid-cap companies undergo M&As together to create financial advantages.
- ▶ For example a mid-cap company goes to borrow a loan from a bank, the bank may charge more interest. But what if two mid-cap companies undergo M&A and as a result, a large-cap company goes to borrow the loan from the bank, they can get benefits since they would have better capital structure and better cash flow to support their borrowings.
- ▶ By going for financial synergy, these two companies not only achieve financial advantages in the case of borrowing loans or paying less interest but they also are able to achieve additional tax benefits. Plus, they are also able to increase their debt capacity and to reduce the combined cost of capital.



## Rationale:

The Rationale in the Scheme: Caution Tax avoidance GAAR no real business or commercial reason. Challenge: Ajanta Pharma

- ▶ value accretive to the shareholders of the combined entity;
- ▶ maximising overall shareholder value due to greater integration and greater financial strength and flexibility for the combined entity;
- ▶ improving organizational capability and leadership, arising from the pooling of human capital having diverse skills, talent and vast experience to compete successfully in an increasingly competitive industry;
- ▶ resulting in rationalization, standardisation and simplification of business processes, and the elimination of duplication, and rationalization of administrative expenses;
- ▶ resulting in the combined entity directly controlling and managing the business which would lead to simplification of the shareholding structure and reduction of shareholding tiers; and
- ▶ a greater financial strength and flexibility to improve the economic and competitive position of the combined entity for future growth and expansion.

Apart from this the Rationale may vary from case to case basis.

# A few important dates/concepts before deciding a Merger :

- ▶ the "Appointed Date": ideally it should be any 'calendar date' as may be fixed by the Board of Directors.
- ▶ The Ministry of Corporate Affairs (MCA) via General Circular No. 90/2019 F.No.7112/2019/CL dated 21<sup>st</sup> August, 2019 issued a clarification regarding "appointed date" in the scheme of M&A under the Companies Act, 2013 that, the companies may choose the "Appointed Date" of M&A based on occurrence of an event, which is relevant to M&A between companies. This would allow the companies concerned to function independently till such event is actually materialized as per the said circular of MCA.
- ▶ Marshall Sons & Co. India Ltd. v. ITO, 223 ITR 809,1997 Supreme Court

- ▶ the "Effective Date": ideally should be the last of the dates on which the certified or authenticated copies of the orders of the National Company Law Tribunal (NCLT) sanctioning the Scheme are filed with the respective Registrar of Companies by the companies entering into scheme of M&A. However, the scheme of M&A as approved or imposed or directed by NCLT shall always be effective from the Appointed Date but shall be operative from the Effective Date. Hence, the Effective Date technically is an 'operative date' and has very less scope in the actual implementation of the scheme of M&A in the accountancy and taxation matter apart from registering an order with the respective Registrar of Companies.
- ▶ the "Record Date": ideally should be the date to be fixed by the Board of Directors of the transferee company in consultation with the Board of Directors of the transferor company which shall either be the Effective Date, or a date after the Effective Date, for the issue and allotment of the equity shares of the transferee company to the shareholders of the transferor company pursuant to the scheme of M&A upon merger of the transferor company into the transferee company.

# Mergers recent Indian Examples.

- ▶ Mittal Steel merged with the Luxembourg based steel giant 'Arcelor Steel.' The deal valued whopping \$33.1 billion. The new company, 'ArcelorMittal,' has now become the world's biggest steel company.
- ▶ Tata Steel recently acquired 'Bhushan Steel' for ₹ 35200 crores through the Insolvency proceedings under National Company Law Tribunal (NCLT). Though the deal looks good for Tata, it is yet to be seen if 'Tata Steel BSL' follows footsteps of ArcelorMittal or Tata Steel Europe.

- ▶ Jaiprakash Group's 'Jaypee Cements' accumulated a lot of debt for itself. It even had to let go of its holding in the IPL team 'Deccan Chargers.' Circumstances were forcing JayPee to go under the hammer at the NCLT through the newly litigated insolvency process. Jaypee was concerned that they would not get a reasonable price in NCLT because everyone would know that they are desperate to be sold.
- ▶ They chose to go to the Aditya Birla Group that owned successful 'UltraTech Cement' (acquired from the L&T group). The deal would not only give a geographical expansion to UltraTech Cement; it would get access to high-end contracts like Expressways that were under Jaypee Associates. The deal was worth ₹ 16,189 crores and added 21 million tonnes capacity to the UltraTech cement.

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- ▶ Hindustan Unilever Limited (HUL) acquired GSK Consumer Healthcare of GlaxoSmithKline (GSK). The deal worth of ₹ 27,750 crores would give away products like Horlicks and Boost in HUL's basket. Since this deal would affect the competition in the Indian FMCG market, because the two companies are giants of the game, the approval from NCLT was needed.
- ▶ While the amalgamation mainly benefits HUL because it gets a new range of renowned products, GSK would take all this money to establish its original production in Bangladesh. This is not a positive sign for Indian business.
- ▶ The NCLT Bench at Chandigarh on 26<sup>th</sup> February, 2020 sanctioned the scheme between GSK and HUL. This clears the decks for GSK Plc. to cash out its 5.7 per cent stake in HUL making it potentially the largest block trade in India.

- ▶ In June, 2018, German chemical and pharma major Bayer AG had announced completion of the USD 63 billion mega-deal to acquire US-based biotech major Monsanto to create the world's biggest agro-chemical and seed company.
- ▶ In India, on September 13, 2019, the NCLT approved the merger of Monsanto India Limited into Bayer CropScience Ltd. Post the merger, Monsanto products will retain their brand names and become a part of Bayer's product portfolio.
- ▶ This integration brings together two highly complementary businesses and added that Indian farmers would benefit from its innovative crop protection products and Monsanto's expertise in seeds & traits and digital farming application. With the integration of Monsanto into Bayer in India, the company will be able to provide Indian farmers a strong portfolio of innovation-led agricultural solutions.

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- ▶ Telecom Sector is in grave crisis since a long time. From the day the 2G Scam accusations surfaced, the government policies and market dynamics have hampered this sector severely.
- ▶ Launch of 'JIO' acted like the fuel in fire situation. The predatory pricing led to the two giants of telecom coming together to take on the new rival. The Vodafone-Idea group is the second-largest telecom network in India after Airtel.
- ▶ Unlike other mergers, this is the merger of equals. In the new company named Vodafone-Idea, Vodafone has 45.1% holding while Aditya Birla Group and Idea shareholders combine hold 54.9%.



- ▶ DIL Ltd. announced the merger of its subsidiary, Fermenta Biotech Ltd., one of the leading Vitamin D3 manufacturers, with DIL. The NCLT has approved the said merger vide its Order dated 19<sup>th</sup> September, 2019.
- ▶ The merger took place purely in the interest of business growth, in order to combine resources of both companies, effectively manage operations, focus on business priorities and maximisation of stakeholders' benefits.
- ▶ Case References: Miheer H. Mafatlal v Mafatlal Industries Ltd [(1996) Company Law Journal 124 and
- ▶ Hindustan Lever Employees Union v Hindustan Lever Limited and others AIR 1995 S.C. 470.
- ▶ Hindustan Lever and Anr. Vs. State of Maharashtra and Anr. reported at 1 CLJ 148 SC (2004)

**Thank You !**

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## Mr. Sanjay Buch, Partner

52, is a Senior Advocate & Solicitor also partnering in M/s. Crawford Bayley & Co. Advocates & Solicitors, a reputed law firm in existence since 1830. Mr. Buch is practicing as a professional for past 28 years and has been witness to the sweeping changes made in the Regulatory Environment. He is known for his business acumen and practical approach in solving complex legal issues and resolving business disputes in the arena of Mergers & Acquisitions and is involved right from the days of TOMCO'S merger with Hindustan Unsilver Limited, also known as mother of all Mergers.

Mr. Buch is also serving as a legal advisor and an Independent Director on the Boards of a several reputed companies. He is also associated with National Stock Exchange's Steering Committee on Security Laws, Associated Chambers of Commerce and Industry, Confederation of Indian Industries, Bombay Chamber of Commerce, Indo-German Chamber of Commerce, Indo-American- Chamber, Indo-Italian Chamber, Chamber of Tax Consultants, Forum of Free Enterprises and other such prestigious institutions.

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