<u>Mergers and Acquisitions- A basic understanding and governing laws</u>

Mergers and Acquisitions (**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.

Merger means the combining of two or more companies, generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock. Basically Merger is a process by which one or more corporation is totally absorbed by another. Thus Merger is the fusion of two or more 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, debentures in the transferee company or in the cash or combination of all the above modes.

The acquisition is the buying of one company (Target Company) by another. A corporate action in which a company buys most, if not all, of the target company's ownership stakes in order to assume control of the target firm. Acquisition can be **friendly or hostile**. In friendly acquisition the companies comes on the terms through negotiations while in the hostile acquisition no negotiation made between companies and the acquiring company need to actively purchase the substantial stake to have majority stake in the target company. Sometimes a smaller company 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**.

Motive behind the Mergers and Acquisitions

i. A combined company can reduce its fixed cost and so can reduce the cost of the production and can befitted with the economies of large scale
ii. If the buyer is purchasing a competitor from the market it will definitely reduce the competition and enhance the market power of the buyer and results in the revenue and market share of the buyer.
iii. It will explore the opportunity of managerial specialization.
iv. A profitable company can buy a loss maker to use the target's loss as their advantage by reducing their tax liability.
v. Geographical diversification.
vi. To make vertical integration. 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.
vii. For the purpose of increasing the market share of the company

Funding of Mergers and Takeovers

There following are some methods of funding mergers and acquisition:

i. Equity Shares in the transferee company
ii. Preference shares in the transferee company
iii. Debentures in the transferee company
iv. Cash payment
v. External commercial borrowings
vi. ADR/GDR
vii. A combination of all above methods.

Indian laws regulating mergers and acquisitions

The following laws regulating the mergers and acquisitions in India:

Companies Act 1956

Section 391 to 394 contains major provisions for mergers and acquisitions. The provisions also deal with the compromise or arrangement with or without merger. Presently High court enjoys the power of sanctioning amalgamation matters under sec. 394. Any company, creditor or class of creditors or member or class of the members can file application seeking sanction of scheme of compromise or arrangement, but due to its very nature the scheme for amalgamation is normally presented by the company. The following procedure shall be followed

i. Examine the MOA of the company. The object clause should permit to regulate, if not so provided in the clause amend accordingly.
ii. Convey board meeting to approve and draft the scheme of amalgamation and for authorization of filing application to the High court.
iii. File application to High court to issue directions to convey the general meeting.
iv. The High court pass the necessary directions which shall include time and place of the meeting, chairman of the meeting, procedure to be followed in the meeting and time to submit the report of the meeting to the court.
v. Send notices to shareholders and creditors, Stock Exchanges and also advertise the notice of the meeting in the two daily news paper one in English and other in the regional language.
vi. Hold the general meeting as per court's direction. The scheme shall be approved by 3/4th majority.
vii. File the report of the meeting to the court and stock exchanges within 7 days.
viii. File resolution with the ROC.
ix. File petition to the court for sanctioning of the scheme.
x. Within 30 days of sanctioning the scheme file courts order with ROC.

SEBI Takeover Code 1997

The objective of the Takeover code is to regulate in an organized manner the substantial acquisition of shares and take over of a company whose shares are quoted on a stock exchange i.e. listed company. In a limited sense these regulations also apply to certain unlisted companies including a body corporate incorporated outside India to an extent where the acquisition results in the control of a listed company by the acquirer.

<u>Regulations regarding limits according to which shares shall be acquired</u>:

The regulation for the minimum amount of shares to be acquired and a public announcement to be made in accordance with it are given under regulations 10, 11 and 12.

a) **Regulation 10**- According to this regulation, no person either alone or with someone acting with the same intention shall acquire shares in a company that would enable the person or persons to practice more than 15% voting rights. The regulations further say that, this could only be done by a person who has made public announcement to acquire such shares in accordance with the regulations. In other words a person by himself or with a person acting with the same intention shall make a public offer to acquire a minimum of 20% of shares in accordance with the regulation.

b) **Regulation 11**- This regulation talks about an Acquisition by a person or two or more persons acting together with common intention, who have already acquired 15% or more but less than 55% of share or voting rights, which would enable them to exercise further 5% but not more voting rights in the same financial year ending on 31st March. Though this can be done if the acquirer makes a public offer to acquire such shares in accordance with the regulations. The regulation further talks about acquirers who already have 55% or more shares but less than 75% shares of the target company but intend to acquire more shares, this can only be done if the acquirer makes a public announcement in this regard

c) **Regulation 12**- The regulations further say that, any control over the company shall not go into the hands of the acquirer irrespective of whether acquisition of shares or voting rights has taken place or not, until a public announcement to acquire such shares has been made in accordance with the regulations.

Competition Act 2002

Competition Act 2002 was enacted to ensure free and fair competition in the market by prohibiting anti-competitive agreements, abuse of dominant position and combinations likely to have appreciable adverse effects on competition within the relevant market in India. Competition act also keep watch on the mergers and acquisitions by the Indian companies. Sec 5 and 6 deals with the mergers of the company. Section 5 of the act deals with 'Combinations" which defines combinations with reference to assets and turnover

(a) Exclusively in India and
(b) 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. The act requires the competition authority to approve or reject mergers on the basis of competition only.
Section 6 says 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.

Income Tax Act 1961

The term amalgamation is defined in sec 2 (1B) of the act. It covers mergers also.
Some important provisions of income tax act regarding mergers and acquisitions are as follows:
Section 2 (IB): 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:

i. All the properties and liabilities of the transferor company/companies become the properties and liabilities of Transferee Company.
ii. 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.

Section 47 (vi): Any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company is not regarded as transfer and not chargeable to tax.
Section 47 (vii): 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 49 (2): 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 72A: Government can allow carry forward of losses and unabsorbed depreciation provided the amalgamated company carry on the business of the amalgamating company for at least 5 years.

No Sales tax on mergers and amalgamation.

Foreign Exchange Management Act 1999

FEMA is regulating the cross border mergers and acquisitions. 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 outside India) Regulation, 2000 issued by RBI vides Notification No. FEMA 20 /2000-RB dated 3rd May, 2000. These regulations contained general provisions for inbound and outbound cross border mergers and acquisitions in India.. Under these provisions once the scheme of merger or amalgamation of two or more Indian companies has been approved by a court in India, the transferee company or new company is allowed to issue share to the shareholders of the transferor company resident outside India subject to the condition that:

i. The percentage of shareholding of person's resident outside India in the transferee or new company does not exceed the sectoral cap.

ii. The transferor company or the transferee or the new company is not engaged in activities, which are prohibited in terms of FDI policy.

Conclusion:

The legal and financial reforms by the government of India since the early 1990's have resulted in substantial growth of the Indian economy. With the liberalized policies the practice of mergers and acquisitions has attained considerable significance in the contemporary corporate scenario in India which is broadly used for reorganizing the business entities. According to a recent study, mergers and acquisition activity in the country more than doubled in the first month of 2010 as deals worth nearly USD three billion (about Rs. 13,950 crore) were announced amid improved signs of liquidity. Indian companies have shown their globle presence by acquiring some big companies outside India The most important benefit that the developing and transition economies derive from outward investments is increased competitiveness. This strengthens the arms of local companies and of the MNCs to survive in a competitive milieu. Therefore, the more the domestic industries invest abroad, the more the benefits to the home economy.