

**DE JURE NEXUS LAW JOURNAL**

Author:

Disha Agarwal

ICFAI Law School, Hyderabad

BBA LL.B. (Hons.), 5<sup>th</sup> Year.**A MERGER STRATEGY AND A CORPORATE ACQUISITION: A  
CRITICAL STUDY**

Globalization and Liberalisation has led to the emerging trends of competition in the local as well as global market. The Indian Competition market has undergone vital changes leading to a significant transformation since the nineties. The pursuit of growth to access new markets have propelled the companies to undertake mergers, acquisitions etc. After 1991, as economic reforms were introduced and due to the relaxation of industrial policies, there was a spurt in the activities related to corporate restructuring. In a competition driven economy integration, consolidation, liquidation, restructuring of corporate entities are inevitable.

Corporate Restructuring is the process carried out by an entity which results in substantial change in the company's business, model, arrangement, management or financial structure. It is targeted at rebuilding or rearranging the corporate structure to gain competitive advantage in the market. Corporate Restructuring can be carried out in the following ways such as Merger, Acquisition, Amalgamation, Takeover, Joint venture, Reverse mergers, Demerger etc. An arrangement for reconstruction is considered as a contract and the parties are free to decide its terms and conditions<sup>1</sup>. M & A transactions are considered as crucial business strategy to sustain and compete with the dynamic market.

**Merger:** A merger is defined as the combination of two or more companies in which the assets of the selling company are absorbed by the buying company, wherein the buying company can retain its original identity after merger or subsequently both the companies may merge forming a distinct identity.

---

<sup>1</sup> In Re: Apex Investments Pvt. Ltd. (1992) CLA 20 (Del)

**Amalgamation:** An amalgamation is defined as a process whereby two or more transferor companies merge into an altogether another entity known as the transferee company. The transferor company loses its identity. Amalgamation contemplates a state of things under which two companies are so combined so as to form a third entity.<sup>2</sup>

In India, the words merger and amalgamation are used interchangeably but there exists a thin line of disparity between the two. In case of merger, the resultant entity may have the identity of the buying company and may not necessarily be a new entity but in case of amalgamation, the resultant entity is always a new entity.

**Acquisition:** Acquisition can be defined as directly or indirectly acquiring or agreeing to acquire the shares or voting rights or control of the target company. The acquirer company will be entitled to all the assets, liabilities of the target company.

**Takeover:** Takeover usually takes place when one company acquires controlling interest over the target company. The major determinant in case of takeover is the factor of control. In order to construe, whether takeover has taken place or not the determinant control has to be analysed taking into account various factors.

Though the expressions acquisition and takeover are taken as synonymous, the disparity lies in the word itself. Acquisitions are generally mutually agreed upon transactions, whereas takeovers, as the word itself suggests are hostile.

### **The concept of Control:**

The genesis of corporate glitches usually arises from ambiguity in relation to the concept of control. The definition of control is distinct under different statutes of law. It is also elusive throughout the globe. There is no definitive meaning of control in relation to Mergers and Acquisitions. There are a number of statutes which seek to define control such as Companies Act, 2013<sup>3</sup>, SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011[‘Takeover Code’]<sup>4</sup>, Competition Act, 2002<sup>5</sup>, Under these statutes, acquisition of control

---

<sup>2</sup> S. S. Somayajulu v/s Hope Prudhomme And Co. Ltd, (1963) 2 Comp LT 61 (AP)

<sup>3</sup> Section 2(27), Companies Act 2013, Act No. 18 of 2013.

<sup>4</sup> Regulation 2(e), SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011, Notification No. LADNRO/GN/2011-12/24/30181.

<sup>5</sup> Section 5, Competition Act 2002, Act No. 12 of 2003.

triggers certain events such as merger or acquisition, provision of an exit option to the concerned shareholder etc.

The concept of control is premised either on quantitative or qualitative definition of control. The quantitative definition of control focuses on the de jure control i.e qualifying a certain percentage of the threshold as provided by the legal provisions. The qualitative definition of control relates to the de facto control, wherein control is ascertained by the facts and circumstances of the case. It does not provide a specific threshold, nevertheless the aspect of control is determined on the basis of other factors such as being in a state to control the affairs of the company without existence of a legal right to do so. In relation to M&A, the concept of control is to be ascertained on the basis of its definition under Indian Competition Act, 2002 and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011.

The attempt to define control dates back to 1997, wherein a committee was constituted under the chairmanship of P.N Bhagwati to review the takeover regulations and provide a determinative definition of control. The committee recommended a broad definition of the term control and stated the same shall be decided by SEBI on case to case basis. The committee opined that the attempt to define would limit the scope of the regulation. In order to conform with the fluctuating market conditions frequent amendments were made. The perspective of the Bhagwati Committee was reiterated by Takeover Regulations Advisory Committee (TRAC), in its report in 2010.

The need to further define control shall be viewed in light of the recent attempt by the CCI through Discussion paper on Brightline. In respect of the inconsistency in the definition of control, SEBI floated a discussion paper<sup>6</sup>, a proposed policy framework to set out what amounts to the bright lines of acquisition of control. SEBI proposed 2 options through the discussion paper for determining control:

- 1) Option 1: This option was given in light of the decisions passed by SAT reaffirming the exercise of positive or proactive rights as would enable a person to control as opposed to negative or reactive rights.<sup>7</sup> It aimed at distinguishing protective and participative rights exercised by the investors. It states that negative rights, affirmative voting rights or protective

---

<sup>6</sup> Securities and Exchange Board of India, Discussion Paper on “Brightline Tests for Acquisition of „Control“ under SEBI Takeover Regulations”, SEBI, (Aug. 21, 2017), available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1457945258522.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1457945258522.pdf).

<sup>7</sup> Subhkam Ventures Private Limited v. SEBI, (2010) SCC Online SAT 35, In the matter of Kamat Hotels (India) Limited, WTM/GM/EFD/DRAIII/20/MA 2017.

clauses shall not be construed as control. These rights have been accorded so as to protect the investors' rights from dilution. It provides an illustrative list such as appointment of chairman/vice chairman, appointment of observer, veto rights, quorum rights, the exercise of the same shall not amount to control.

2) Option 2: This option prescribes the numerical threshold to determine control.

It prescribes the right to exercise 25% of voting rights of a company as a determinant of control or b) the right to appoint majority of the non-independent directors of the company.

Though the paper sought to provide a clarification on the interpretation of the term control, the two options were heavily criticized.

The first option attempts to restrict the scope of the definition of control, though it is pertinent to note that it is impossible for SEBI to provide an exhaustive list that encompasses every kind of situation. It is imperative to state that by providing an illustrative list, the regulators, investors might strictly follow the list and interpret inaccurately. As regards to the set of circumstances and conditions encompassed within the list, there lies ambiguity with reference to status of appointment of 1 or more directors, the condition pertaining to minimum 10% of investment in the target company, its application to subsequent acquisitions etc.

The primary shortcoming of the second option is the fixed numerical threshold may enable the investors to evade the requirement using different methods, consequently they would be precluded from making an open offer thereby hampering the interests of minority shareholders. It is imperative to note that the acquirer may stay below the threshold in order to elude the trigger and still exercise de facto control over the company. This is considered as the major lacuna which the discussion paper has failed to discuss.

Thus, each of the options proposed by SEBI suffer from conceptual and operational drawbacks. Subsequently, after extensive discussion the proposal of Bright line Test has been scrapped.

### **Objectives of Mergers & Acquisitions:**

The objectives of M & A are fluctuating on the basis of market requirements and the dynamic firms' objectives. Few standard objectives are discussed below:

**Diversification:** A firm can enter into a distinct line of product through merger or acquisition. The purpose of diversification can be to offer new products to consumers, to diversify costs, risks etc. The process of diversification is usually carried out to gain competitive edge in the

market. Example: The acquisition of Electronic Data Systems by Hewlett-Packard in 2008 to add its computer service corporation as a part of HP.

Synergy: The rationale behind most of the mergers or acquisitions is to create operational synergy. Such kind of a merger or acquisition between two firms may result in low cost of production, higher earnings, more product lines etc. The classic example for this would be the Merger of Ranbaxy and Crossland Laboratories in 1997, leading which Ranbaxy emerged as the country's second largest pharmaceutical company.

Market share: The primary objective behind a merger especially a horizontal merger can be increase in the relevant market share. Increase in market share leads in the rise of industry concentration which provides better opportunities for the firm to control the suppliers, customers etc. Example: Acquisition of TOMCO by Hindustan Lever leading to its increased share in the market above 60%.

Tax benefits: Mergers and acquisitions lead to tax implications. Section 72 A of the Income Tax Act, 1961 provides tax benefits for the revival of sick units. When a profit-making company acquires a loss-making company and thereby absorbs its losses, the tax liability is diminished by utilising the net operating losses.

### **Impact & Analysis of Mergers and Acquisition:**

Positive Impacts of M & A:

M & A create various kinds of positive impacts on a Company such as better results on financial performance, increased profitability, better leverage in the market, liquidity of the assets of the Company. However, it is imperative to note that consequences of mergers and acquisitions depends on a variety of factors such as fair valuation adopted by the company at the time of negotiations, strategic measures adopted pre and post-merger and acquisition, upright stakeholder approach, effective guiding principles etc.

Negative Impacts of M & A:

Local and international research studies in relation to M & A indicate that despite carrying out pre and post diligence, large numbers of mergers and acquisitions transactions fail to reach the intended potential. The failure is divided into two broad categories- fit and process. Fit issues are those issues where the juxtaposition between acquirer and target company is contemplated- size, diversification, poor strategic and organizational measures, lack of implementation of

cultural values etc. Process Issues are those issues over which the acquirer has control to a larger extent such as lack of proper communication, lack of management of employees, inefficient top management etc.

### **Issues arising during Mergers & Acquisitions:**

**Valuation:** The valuation process in M & A is subjective and an unformulated process. The substantial part of the litigation in mergers and acquisitions takes place due to valuation, it being a subjective element. Valuation is a process that is initiated by the target company that sets out as value or the minimum price the purchaser should be willing to make in order to acquire control over the target company. The seller responds at the offer made by the bidder or could make his own valuation which is subject to the acceptance of the target company. There are different methods for valuation such as Asset approach, Income approach, Market approach. Most of the M & A's fail to bridge the value-price gap. In the case of "*Hindustan Lever Employees Union vs Hindustan Lever Ltd*"<sup>8</sup>, the Court opined that it does not have the jurisdiction to ascertain the mathematical accuracy, its jurisdiction is limited only to ensure that the value is fair and just. Various issues can rise in relation to valuation for instance, different methods of accounting principles adopted by the companies, the impact of inter-holdings in merging companies, existence of exotic/hybrid instruments- providing an option to convert etc.

Classic example of a failed merger due to the difference in valuation technique is the 'Hill-TOMCO' merger wherein the swap ratio as deduced by the independent committee was valued at 5:15 as against the value of 2:15 as agreed by the parties involved.

**Cultural Issues:** Culture has emerged as one of the biggest factors for failure of M & A. Every company has a different cultural framework which is in continuance past generations. The primary shortcoming is the failure to recognise the culture of both the companies involved in the merger or acquisition not alone the acquirer company. The leadership style, decision making style, formal structure, ability to change, implementation of strategies have their roots from the culture of the company. Inconsistencies or Discrepancy in the cultural backdrop can have unfavourable consequences on the merged or the acquirer entity.

'Daimler Chrysler' merger is an example of the challenges inherent in cultural integration. The merger failed due to fundamentally different cultural background of both the companies.

---

<sup>8</sup> 1994 SUPPL. (4) SCR 723

Daimler-Benz followed centralized decision making giving due consideration to tradition and hierarchy while Chrysler had more of a flexible, risk-taking reputation.

HR issues: M & A activities yield different sets of challenges in relation to human resources such as job losses, restructuring, uncertainty in the environment, differences in organizational structure, difference in managerial style all of these factors tend to have a direct impact on employee morale. It is significant to understand the impact of the entire process of M & A on employees which is often overlooked. Financial, Economic matters take precedence over human capital.

Examples: The acquisition of TSS (Thermax System Software) by Global Tele Systems, nearly 2/3<sup>rd</sup> of the employees left TSS due to various HR related issues.

Sify's e-business merger with Satyam, the merger failed due to different views of employees on technological integration issues.

Poor Integration Process: Most of the M & A's fail due to the post-merger integration failure. It is incumbent to formulate a set of guiding principles in consonance with the target company which are in line with the strategic intent of post-merger or acquisition. These principles shall encompass policies, procedures which lay down the basis for the activities that can be carried out in the post integration period.

Poor Stakeholder & Shareholder approach: M & A activities usually neglect the shareholders interest in the Company during the due diligence process which makes them turn hostile towards the Company and thereby leads in failure of M & A. On the other hand, Stakeholders include investors, suppliers, creditors which are directly or indirectly related to the company, they are often neglected in the entire process in the merger or acquisition. While financial and economic activity gains precedence, poor approach towards shareholders and stakeholders such as improper communication, lack of participation in the decision-making process etc.

Example: 'ABB-Flakt merger'- its branches in India also merged. It was revealed during the course of the merger that there was no proper due diligence due to which the gain of merger was less than the capital market growth. This resulted in the heavy loss to the erstwhile shareholders of Flakt.

**Other factors:** There are various other issues such as geographical constraints, overestimated synergies, high recovery costs, failure of top management, external economic and environmental factors. The factors mentioned above are illustrative and not exhaustive.

**A way forward:**

- A complete thorough due diligence is required by the entities to discover the hidden liabilities in the integrated company and thereby assess the potential risks involved in the proposed transaction. It is essential to carry out due diligence prior and after the proposed transaction. It includes review of financial statements, managements and operations, legal compliances, employee regulation etc.
- It is significant to have a constructive communication system throughout the process of merger and acquisition. Effective communication strategies that ensure integrity and accessibility across all hierarchical levels of organisation. It is crucial to include the bottom-level management in the decision-making process as well.
- The entire process of merger and acquisition is pessimistic for Employees. They fear job loss the most. It is vital to have clarity regarding job loss, salary deduction, demotions, transfers etc and formulate a mechanism to communicate it explicitly with the employees and provide a smooth transition for employees.
- Culture, being one of the most inherent issues in M & A transactions. It is pre-emptory to formulate a rigorous program with explicit objectives in respect of cultural integration after carrying out a bilateral cultural audit. Providing language training, encouraging cross-culture, training multi-cultural team to bridge culture gap, such techniques can be adopted to deal with the cultural integration process.
- Strong Governance and execution management form an important part throughout the M & A process. Transparency in dealing with customers, employees, stakeholders will go a long way in the success of the M & A.
- In most of the cases, firms concentrate on attaining synergies but fail to give due consideration to integrating customers and retaining them. With the level of uncertainty that M & A's raise it becomes crucial to adopt customer preservation strategies. running an intelligence mechanism in the market place, taking regular customer feedbacks, actively adhering to the needs of the customers pay way for success and enhancement of M & A.

**Emerging Trends Post Covid-19:**



During the unprecedented times of Covid-19, M & A transactions have been affected drastically. It has affected various aspects of transactions in relation to M & A such as delays and drop-outs in the deals, uncertainty in the cross-border investments, debts, insolvency, government compliances, regulatory delays and many more. The special emphasis on Material Adverse Clause, wherein both the parties will negotiate the extent of this clause based on their best interests.

Post-Covid-19, numerous opportunities may emerge in certain specific sectors such as digital sector, pharma industry. Mergers and Acquisitions of regional companies may enhance due to the Government's Make in India initiative and potentially viewing the risks involved in cross-border transactions amid Covid-19. The EdTech space has seen developments in the past few months. BYJU's is steadily gearing up to acquire (i) WhiteHat Jr, a smaller rival of BYJU's; and (ii) DoubtNut, a recent learning app which will provide information to BYJU's from customers of smaller cities, towns. Another classic example of an emerging opportunity amidst Covid-19 is Aakash Educational Services Limited which set up its new subsidiary for enhancing its digital learning segments. The acquisitions are also extended in the online grocery delivery services, with the acquisition of DailyNinja- a milk delivery platform by Big Basket. A new trend of acquisition in the tech industry is emerging amidst Covid-19, 'acqui-hiring' wherein the companies recruit and acquire the employees or where acquisition takes place primarily for talent with emerging skills. Hug Innovations, an IoT start-up was recently acquired by Titan. Huge Indian Companies like Infosys is seeking for M & A opportunities globally focused on cloud and data business platforms.

The aftermath of Covid-19 will be heavily felt on the M & A sector however it may precipitate with time and evolving regulations to curb its drastic consequences.

## **CONCLUSION**

M & A strategies form an intrinsic part of the competition market. All the sectors will have to revisit their business outlook and strategies amid Covid-19. There might emerge broad spectrum of opportunities in certain sectors like tech sector, edtech, health-care, pharmaceutical industry, health and life insurance, ecommerce industry. On the other hand, there are many sectors which will have adverse impact and thereby experience a down trend. Areas like construction companies, textile industry, automobiles, aviation, hospitality sector. Covid-19 crisis will severely affect every sector and aspect of M & A, it is only with time and strategic business decisions coupled with regulatory aid that a firm can recover.

In addition to the Covid-19 crisis, the concept of M & A's has still not evolved in line with the changing needs of the market. The legislation pertaining to M & A is quite ambiguous when seen as a whole. There is not an exclusive legislation covering all the aspects of M & A under one umbrella. Having to abide by rules from different authorities such as SEBI, SAT can be seemingly difficult for many organisations. There are boundless regulations to comply with, apart from this the whole M & A process is too time consuming and prodigal which refrains the local or micro-enterprises from undertaking it. Thus, the process shall undergo a paradigm shift from being complex, time-consuming and expensive to a simple yet comprehensive one.

