MERGERS AND ITS ROLE IN CORPORATE STRUCTURES

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ABSTRACT:

Mergers play a significant role in the blooming corporate sector. It involves two firms or companies combing to form a larger entity either by way of mutual agreement or takeover. This article mainly deals with the general issues regarding the merger, its advantages and disadvantages and its role as a restructuring arm.

Key Words: Merger, Investment, Amalgamation

GENERAL ISSUES RELATING TO A MERGER

Mergers are extremely significant for regional as well as international large-scale businesses. On one hand, merger activity enables businesses to address concerns relating to restructuring, expansion, and bringing in economies of scale. On the other hand, cross-border mergers and foreign direct investment assist in promoting foreign trade, economic interdependence between different countries, transfer of technological know-how, innovation, and increasing global competitiveness.

APPLICABILITY OF LAWS

In India, the regulatory framework of mergers and amalgamations comprises of the following:

- Companies Act, 1956
- Companies (Court) Rules, 1959
- Competition Act, 2002
- Income Tax Act, 1961
- Securities Exchange and Board of India (**SEBI**) (Listing Obligations and Disclosure Requirements) Regulations, 2015 and SEBI circular dated 30 November 2015 bearing no. CIR/CFD/CMD/16/2015 (**SEBI Regulations**)

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- Stamp Acts applicable to the respective states

Presently, the Companies Act, 1956 allows a cross-border merger only where the transferor company is a foreign company. For more information, see Practice Note: Regulatory considerations

In addition, the Competition Act, 2002, establishes merger review and control procedures designed to prevent mergers which will have an appreciable adverse effect on competition in India. In case of a cross-border merger, a key issue is the multiplicity of jurisdictions. For instance, there may be a high possibility of conflicting decisions relating to the competition aspects of the same merger from two different authorities in two different jurisdictions. Section 32 of the Competition Act, 2002 empowers the Competition Commission of India to inquire and pass orders in cases of transactions taking place outside India but having an appreciable adverse effect on competition in India. Mergers can have significant tax implications. Various tax benefits and tax credits may be transferred to the transferee company pursuant to the scheme of amalgamation

Listed companies (transferor or transferee) have to comply with the provisions of the SEBI Regulations in the process of undertaking a merger. Listed companies should present the scheme of amalgamation to the stock exchanges with the requisite documents and follow the timelines as prescribed in the SEBI Regulations. For more information, see Practice Note: Procedure for undertaking a merger and Filing a merger (with timelines) all variants--checklist

An order of the court sanctioning a scheme of amalgamation is liable to stamp duty as per the Stamp Act applicable to the respective state.

ADVANTAGES OF UNDERTAKING A MERGER

Mergers may be used as a significant tool by companies for expanding their business, increasing their profits, increasing access to markets or creating financial synergies. Some of the advantages of undertaking a merger are:

- Increase in profits
- Access to more markets
- Cost reductions
- Creation of financial synergies

- Efficiency of financial planning
- Access to better technology and products
- Diversification of business
- Value generation for shareholders
- Operational flexibility and saving on duplication of administrative costs
- Tax benefits

The Bombay High Court has held in PMP Auto Industries Limited v N.R., LNIND[2]that "Section 391 invests the court with powers to approve or sanction a scheme of amalgamation/arrangement which is for the benefit of the company. In doing so, if there are any other things which, for effectuation, require a special procedure to be followed - except reduction of capital - then the court have powers to sanction them while sanctioning the scheme itself. It would not be necessary for the company to resort to other provisions of the Companies Act or to follow other procedures prescribed for bringing about the changes requisite for effectively implementing the scheme which is sanctioned by the court. Not only is section 391 a complete code as held by the courts, but, it is intended to be in the nature of a "single window clearance" system to ensure that the parties are not put to avoidable, unnecessary and cumbersome procedure of making repeated applications to the court for various other alterations or changes which might be needed effectively to implement the sanctioned scheme whose overall fairness and feasibility has been judged by the court under section 394 of the Act."

Thus, the advantages of proceeding with a court-based merger are as follows:

- There is a single window clearance system wherein separate/duplicate documents do not have to be filed for different aspects of the merger since the merger takes effect through a single order sanctioned by the court. For more information, see practice note: effect of order
- There is no separate filing required for transfer of assets and liabilities from the transferor company to the transferee company
- Change of name of the transferee company can be effected through the scheme, thus dispensing with the need of approval from the shareholders of the transferee company. On

[2] PMP Auto Industries Limited v N.R., LNIND 1991 Bom 625

the scheme becoming effective, the registrar of companies shall issue the certificate for change of name of the company. No separate document is required to be filed by the transferee company in this regard

- Change of objects clause of the transferee company to cover objects of the transferor company can also be effected directly through the scheme without requiring separate shareholder approval
- Upon the scheme becoming effective, the authorised share capital of the transferee company stands increased automatically without any additional process or act being undertaken by the transferee company
- Change of the registered office of the company can be effected through the scheme via single window clearance

DISADVANTAGES OF UNDERTAKING A MERGER

Though mergers provide companies with financial synergies and allow them to focus on their core competencies, there may be potential downsides to a merger as well. The following are some of the major disadvantages of undertaking a merger:

- Clash of cultures- a merger can lead to conflicts if the two companies merging have very distinct and specific corporate cultures or work environments such as a modern innovative company merging with a more traditional conservative firm
- Diseconomies of scale- most mergers help companies in achieving economies of scale. However, sometimes, a merger can result in diseconomies of scale where the cost of production per unit increases instead. For eg, if two small companies merge together to form a larger company, they may not have the expertise and control for running the larger amalgamated company. The initial production costs might also increase, thus resulting in diseconomies of scale
- Consumer perceptions- consumer perceptions about the two companies merging with each other might change if both companies have different brand value. For eg, in the case of a merger between a smaller company with a superior brand image and a large company with a less reputed company. Moreover, mergers often to lead to a reduction in

competition in the marketplace with the amalgamated company having a higher pricing power

- Layoffs- mergers are often used as a method to shut down the underperforming segments of a company and reduce labour force. The impeding layoff of employees following a merger may lead to a reduction in employee motivation and productivity

Formulating a strategy for undertaking the merger, identifying the motives for a merger, identifying a target company which fits such motives and conducting a preliminary due diligence are some of the important pre-merger activities which should ideally be carried out in order to evade the potential disadvantages of undertaking a merger. For more information, see Practice Note: Pre-check before undertaking a merger

MERGER AS A RESTRUCTURING ARM

- Mergers may act as a restructuring tool which helps companies to expand or diversify their businesses, reduce costs, and gain a competitive advantage. Corporate restructuring is often extensively used by business organizations in India to modify their financial structure or business models, and thus increase their shareholder value.
- Mergers ideally act as restructuring tools since they may:
  - Provide opportunities for combining assets thus building a firmer and more sound business
  - Enable optimum utilization of the existing resources at hand
  - Provide opportunities to completely leverage the combined assets, management capabilities, brand name and infrastructure of the transferor and transferee companies
  - Reduce overlaps in managing multiple entities by eliminating duplication of costs and providing greater administrative benefits
  - Increase operational flexibility and efficiency in management
  - Integrate several diverse business functions
  - Enable greater efficiency in cash management through unencumbered access to cash flow generated by the combined business

- Lead to improved leadership and organizational capability and leadership arising from the pooling of diverse skills, talent and experience