CORPORATE RESTRUCTURING

UNIT – I

AN OVERVIEW OF CORPORATE RESTRUCTURING

Introduction

Corporate Restructuring is a branch of corporate and insolvency law that deals with changing the structure of a company. Corporate Restructuring is usually considered by a business that is facing financial issues. The primary purpose of restructuring is to arrange the structure of the company to produce optimum performance. A corporate entity facing financial crisis would consider corporate restructuring before going for the liquidation or the winding-up procedure. Companies hire professional experts such as lawyers and financial firms to advise them to renegotiate transactions and agreements, which will allow them seamless restructuring.

What is Corporate Restructuring?

Corporate restructuring is also referred to as business restructuring. Business restructuring is a process in which an entity changes its legal structure to ensure the seamless running of the business. This process is usually carried out when the business is facing financial or economic problems. When a company is unable to pay a corporate debt, it enters into a restructuring agreement with its lenders. In this agreement, the company's strategy to pay the corporate debt would be mentioned. Creditors and Lenders are an essential part of the corporate restructuring process.

A company's inability to not pay a corporate debt is not the only reason for corporate restructuring. Other reasons can be a company entering into an acquisition agreement, or a joint venture or M & A process.

- When a company wants to grow or survive in a competitive environment, it needs to restructure itself and focus on its competitive advantage.
- A larger company can achieve economies of scale. A bigger size also enjoys a higher corporate status. Such status allows it to take advantage of raising funds at lower cost. Such reduction in the cost of capital results into higher profits.

- Corporate Restructuring focuses on cost reduction and improving efficiency and profitability.
- Corporate Restructuring means rearranging the business of a company for increasing its efficiency and profitability. Today, restructuring is not an option but a conscious choice made by companies.
- Every corporate restructuring exercise aims at eliminating disadvantages and to combine advantages. It plans to achieve synergy benefits through a well-planned restructuring strategy.

Differences between Merger and Acquisition

Sr.	Merger	Acquisition
1	Merger occurs when two separate entities, come together to create a new, joint organization in which both are partners	Acquisition refers to the purchase of one entity by another entity
2	One or more companies are dissolved and new company maybe created	No company is dissolved and no new company is created, i.e. both continue
3	In merger, two companies consolidate into a single entity with a new ownership and management structure.	In acquisition, one company takes over all total operational management control of another company

Joint Ventures

Joint Venture is a separate entity formed by two or more companies to undertake commercial activities together. In a joint venture, a new enterprise is formed with participation in ownership, control and management of two or more parties.

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    - The parties agree to contribute equity to form a new entity and shares the revenues, expenses and capital of the company. E.g. Vistara Airlines is a JV between Tata and Singapore Airlines.

- A joint venture may be of two types —
  i. Project based JV entered into by the companies in order to achieve specific tasks.
  ii. Functional based JV is entered into by companies in order to achieve mutual benefit.
- A joint venture provides access to assets, knowledge and funds from both of its partners it can combine the best features of those companies without altering the parent companies.

Benefits

Corporate Restructuring aims at improving the competitive position of an individual business and maximizing its contribution to corporate objectives.

Through mergers and acquisitions, companies hope to benefit from the following:

(1) Increase in Market Share – Merger facilitates increase in market share of the merged company. Such rise in market share is achieved by providing an additional goods and services as needed by clients. Horizontal merger is the key to increasing market share. **(E.g. Idea and Vodafone)**

(2) Reduced Competition – Horizontal merger results in reduction in competition. Competition is one of the most common and strong reasons for mergers and acquisitions. **(HP and Compaq)**

(3) Large size – Companies use mergers and acquisitions to grow in size and become a dominant force, as compared to its competitors. Generally, organic growth strategy takes years to achieve large size. However, mergers and acquisitions (i.e. inorganic growth) can achieve this within few months. **(E.g. Sun Pharmaceutical and Ranbaxy Pharmaceutical)**

(4) Economies of scale – Mergers result in enhanced economies of scale, due to which there is reduction in cost per unit. An increase in total output of a product reduces the fixed cost per unit.

(5) Tax benefits – Companies also use mergers and amalgamations for tax purposes. Especially, where there is merger between profit making and loss-making company. Major income tax benefit arises from set-off and carry forward provision u/s 72A of the Income-tax Act, 1961.

(6) New Technology – Companies need to focus on technological developments and their business applications. Acquisition of smaller companies helps enterprises to control unique technologies and develop a competitive edge. (E.g. Dell and EMC)

(7) Strong brand – Creation of a brand is a long process; hence companies prefer to acquire an established brand and capitalize on it to earn huge profits. **(E.g. Tata Motors and Jaguar)**

(8) Domination – Companies engage in mergers and acquisitions to become a dominant player or market leader in their respective sector. However, such dominance shall be subject to regulations of the Competition Act, 2002. **(E.g. Oracle and I-Flex Technologies)**

(9) Diversification – Amalgamation with companies involved into unrelated business areas leads to diversification. It facilitates the smoothening of business cycles effect on the company due to multiplicity of businesses, thereby reducing risk. **(E.g. Reliance Industries & Network TV18)**

(10) Revival of Sick Company – Today, the Insolvency and Bankruptcy Code, 2016 has created additional avenue of acquisition through the Corporate Insolvency Resolution Process.

Notable mergers/demergers/acquisitions that took place are Myntra acquiring Jabong, RIL acquiring Network TV18, Sun Pharma absorbing Ranbaxy; Wirpo demerger, Reliance Industries demerger.

The importance of Synergy

All mergers and acquisitions have one common goal, i.e., to create synergy that makes the value of the combined companies greater than the sum of the two parts. The success of a merger or acquisition depends on whether this synergy is achieved or not. Synergy may be in the form of higher revenue streams and cost savings.

Synergy implies that combined result of two enterprises is better that simple addition of each of them, i.e. 1+1 > 2. It means that merger leads to operational efficiencies. The combination of operations creates integration, which in turn increases earnings potential and reduces cost. Synergies can be expected to flow from highly focused operational efforts, rationalization and simplification of processes, rise in productivity, better procurements, and eliminate duplication. It leads to combining their resources, such as production facilities, marketing channels, managerial skills etc. Synergy is based on an ability of an enterprise to utilize its resources for better results in combination with another enterprise.

Need for Corporate Restructuring

- Corporate Restructuring means re-arranging business of a company for increasing its efficiency and profitability. Restructuring is a method of changing the organizational structure in order to achieve the strategic goals of the organization. It involves dramatic changes in an organization.
- The strategy adopted shall depend on the purpose or organizational goals and hence a different strategy shall apply to different companies. Corporate Restructuring aims at different things at different times for different companies and the single common objective in every restructuring exercise is to eliminate the disadvantages and combine the advantages.
- The various needs for undertaking a Corporate Restructuring exercise are as follows –

(a) focus on core competence, operational synergy, cost reduction and efficient allocation of managerial capabilities;

(b) balance utilization of available infrastructure and resources;

(c) economies of scale by expansion to exploit domestic and international markets;

(d) revival and rehabilitation of a sick unit by adjusting losses of the sick unit with profits of a healthy company;

(e) acquiring constant supply of raw materials and access to scientific research and technological developments;

(f) capital restructuring by appropriate mix of loan and equity funds to reduce the cost of servicing and improve return on capital employed;

(g) improve corporate performance to achieve competitive advantage by adopting the radical changes brought out by information technology.

Overview of Corporate Restructuring Industry in India

Globalization has improved the financial landscape in India. The restructuring industry can be analyzed from two aspects. The two types of restructuring are financial restructuring and debt restructuring. The financial restructuring sector has improved due to globalization. The last five years in India have been attractive to the M & A industry. Hence the financial restructuring sector has progressed. When it comes to debt restructuring, it hasn't performed according to the

expectation of investors. The Government of India paved the way to the Insolvency and Bankruptcy Code, 2016 (IBC 2016). Lenders benefitted from this legislation. This wasn't possible before the introduction of the IBC. This has paved the way for creating new strategies for restructuring debts for corporate debtors.

Forms of Corporate Restructuring

- **Financial Restructuring-** Financial restructuring is a form of corporate restructuring strategy which is usually considered when companies merge or get acquired by another company. In this form of Restructuring, often, companies do not face any financial problems. The company is restructured as a result of a share sale or an asset sale in an acquisition. In a share sale, the entire share capital of the company is acquired. In an asset sale, only a specific asset is obtained from the selling company. Financial restructuring can also occur during an M&A process.
- **Debt Restructuring-** Debt restructuring is usually used by a company to change its strategy to pay off a debt. A company may restructure its business, divest a particular subsidiary of the parent company, or raise additional capital to pay off a debt. A creditor or lender would typically allow the company to restructure itself when they have to repay a debt. In this form of restructuring, the parties would enter into an agreement that would bind the company's debtors. The amount of Non-Performing Assets (NPAs) and bad debts has made the government bring in the IBC. Due to this code, the number of bad debts has drastically reduced.

Different Types of Strategic Corporate Restructuring

Based on the type of situation, corporate restructuring can be divided into financial restructuring and debt restructuring. However, the types of strategic corporate restructuring which companies enter into are as follows:

01 Mergers

02 Private Acquisitions

03 Divestment

04 Demerger

05 Reverse Merger

06 Strategic Partnership/Alliance

Mergers

Mergers are understood as a combination of two or more corporate entities. The principal reason for a merger is to enjoy economies of scale and economies of scope. In this form of corporate restructuring, the companies or organizations enter into a merger agreement, where the terms and conditions of the merger are decided. There are lots of complex formalities in the merger process. Expert advice from a transaction specialist is required in this process. At Enterslice, we have experienced M & A experts who can advise you throughout the process. A company merges with another company, just to improve its business. Apart from this, there are different forms of mergers:

a) Horizontal Merger- Horizontal merger is a process in which two companies are operating in the same levels of a production merge.

b) Vertical Merger- Vertical merger is a process where companies merge who are in different phases of the production cycle.

c) Conglomerate Merger- Conglomerate merger is a process in which companies in different business merge.

d) Cash Merger- A cash merger is a process in which one of the companies acquires the other company for a specific amount of cash.

Private Acquisitions

A private acquisition is a process when a company acquires another company. This process is also known as a takeover. A takeover process can be either a friendly takeover or a hostile takeover. In this transaction, there are three parties. The parties are the buyer, seller, and the target company. Private acquisitions normally occur due to increased benefits such as synergies, economies of scale, and economies of scope. The acquisition process is complex and requires expert advice. There are two forms of acquisitions:

Share

This is normally referred to as a share sale. In a share sale, the buyer acquires the entire share capital or a portion of the share capital of the seller or the target company. When a company is acquired as a result of a share sale, all assets and liabilities are transferred to the buyer.

Asset

This is usually referred to as an asset sale. In an asset sale, the buyer has the advantage of acquiring a specific asset. Hence through this process, the buyer can cherry-pick the assets of a company. One of the advantages of an asset sale is the buyer can leave the liabilities with the seller and only purchase the important assets of the target company.

Divestment

Divestment is a process in which a company sells off its subsidiary. Through the process of divestment, the company can reduce the number of debts. This type of strategic corporate restructuring is used in financial restructuring processes as well as debt restructuring processes. In the divestment process, the parent company will usually liquidate or wind up the subsidiary company's operations.

Demerger

This is a form of restructuring where the company divides into two separate groups. In this process, the synergies which are earlier enjoyed by the two entities are divided. A company demerges due to restructuring, reducing the financial burden, and other factors. Optimum

capacity is reduced through the demerger's process, making the company produce the required amount of profits to run the business.

Reverse Merger

In a reverse merger, the private company gets different forms of benefits. A public company acquires a private company in a reverse merger. Due to this, the private company does not need to go through the entire process for applying its shares to be listed in a stock exchange. This form of corporate restructuring is to improve the private company's business without going through the entire process of applying for an initial public offering.

Strategic Partnership/Alliance

Strategic Partnership is also known as an alliance. In a strategic partnership, the companies partner to carry out business. However, a strategic partnership is effectuated through one or more contracts. The partnership is binding on the parties. However, a strategic partnership does not have the effect of a normal partnership or a registered company. A strategic partnership must be differentiated from a joint venture. In a joint venture, two or more companies agree to share profits for a particular period or until the project's execution. Once the period is over, the parties can resume carrying out their businesses.

Applicable Law for Corporate Restructuring Services

The following laws would govern business restructuring services:

- Companies Act 2013 or Companies Act 1956- Section 233 (of the CA 2013) deals with the process in which companies can opt for a fast-track merger.

Procedure for Restructuring

Restructuring an organization is a complex task. The form of restructuring would depend on the main aims of the organization. If the company is paying off a debt, then a different restructuring process will be used. If a company getting merged with another organisation, then the criteria would be different. The following steps have to be followed in a restructuring process:

- **Determination**

In this phase, the main objective of the restructuring exercise is determined. If the restructuring process involves paying a corporate debt, then the debt restructuring procedure can be used. At

Enterslice, professionals will determine your business's needs and guide you to carry the proper procedure to restructure your business.

- **Identification**

We help your organization identify the strengths and weaknesses. Through thorough research, we establish the need to concentrate on improving the business's strengths.

- **Implementation**

Once we analyze your business's strengths, we implement the procedure with the collective strengths of your business. While carrying out this process, we identify potential problems that can be addressed at an early stage in the restructuring process.

- **Post-Implementation Analysis**

We conduct a broad-based analysis of the restructuring exercise and understand the effects.

- **Evaluation of Restructuring**

In the last step, we monitor your organization and provide post-compliance reporting.

VALUE DRIVERS FOR CORPORATE RESTRUCTURING:

Corporate enterprises are motivated to restructure themselves in view of the following forces:

1. The Government policy of liberalization, privatization and globalization spurred many Indian organizations to restructure their product mix, market technologies etc. so as to meet the competitive challenges in terms of cost, quality and delivery. Many organizations pursued the strategy of accessing new market and customer segment. Convertibility of rupee has encouraged many medium-sized companies to operate in the global market.

2. Growth is another driving force for corporate restructuring. In the economic landscape of Europe today many companies are restructuring their activities in order to secure their market share.

3. Revolution in information technology facilitated companies to adopt new changes in the field of communication for improving corporate performance.

4. Wrong diversification and divisionalization strategy has led many organizations to revamp themselves. New business embraced by companies in the past had to be dropped because of their irrelevance in the changed environment. Product divisions, which do not fit into company's core business, are being divested.

5. Improved productivity and cost reduction have necessitated downsizing of the workforce.

6. Another plausible reason for restructuring is improved management. Some companies are suffering because of inefficient management. Such companies opted for change in top management. Sony Entertainment Television India is a case in point.

7. Organizations are motivated to reorganize their financial structure for improving the financial health of the firm and increase the shareholders value.

8. Many organizations embarked on restructuring exercise with a view to integrating their diversified business activities and improving their competitiveness. Indian Companies pre 1991 typically had a diverse unrelated portfolio of businesses and complex shareholding patterns characterized by cross holdings. Upon liberalization of the Indian economy promoters felt an urgent need to rationalize business portfolios, consolidate business interests and enhance promoter control. This led to substantial restructuring activity in Indian corporates.

9. Reorganization of ownership within the promoter group, either due to family settlement or exit of a joint venture partner, has been another key factor for driving restructuring.

DUE DILIGENCE PROCESS FOR M & A:

Due diligence is an essential activity in mergers and acquisitions (M&A) transactions. In the M&A process, due diligence allows the buyer to confirm pertinent information about the seller, such as contracts, finances, and customers. By gathering this information, the buyer is better equipped to make an informed decision and close the deal with a sense of certainty.

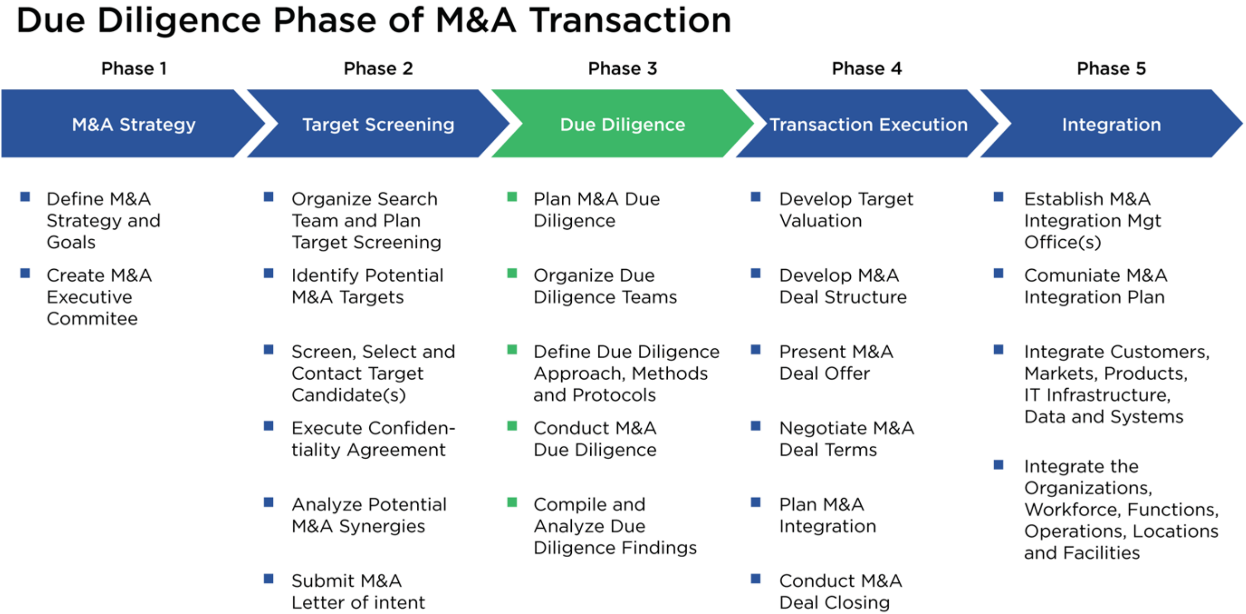
What Exactly Is Due Diligence?

Due diligence is an audit or investigation of a potential investment to confirm facts that may have a direct impact on a buyer's decision to merge or make a purchase. During the due

diligence process, research is conducted to ensure that all facts pan out before entering into a financial transaction or agreement with another party.

In a company acquisition, due diligence typically includes the full understanding of a company's obligations, such as their debts, leases, distribution agreements, pending and potential lawsuits, long-term customer agreements, warranties, compensation agreements, employment contracts, and similar business components.

What Steps Are Involved in Due Diligence?



Why Is Due Diligence Important?

There are many advantages to undergoing M&A due diligence. First, the buyer is better able to adjust their expectations as they review the unique details of a company. This information can also come in useful during negotiations.

When a buyer is able to gather important data on a company, there is a lower risk of unexpected legal and financial problems. Due diligence is essentially an effective way for buyers to protect themselves from risky business deals.

As the due diligence process requires a great amount of communication between the two parties, the businesses are also able to form a working relationship.

ETHICAL ISSUES IN MERGERS & ACQUISITIONS

With the recent mergers and friendly and unfriendly takeovers, two important issues have not received sufficient attention as questionable ethical practices. One has to do with the rights of employees affected in mergers and acquisitions and the second concerns the responsibilities of shareholders during these activities. Although employees are drastically affected by a merger or an acquisition because in almost every case a number of jobs are shifted or even eliminated, employees at all levels are usually the last to find out about a merger transaction and have no part in the takeover decision. Second, if shareholders are the fiduciary beneficiaries of mergers and acquisitions, then it would appear that they have some responsibilities or obligations attached to these benefits.

Broadly speaking:

Utilitarian approach: It views ethics of a merger activity from the perspective of gains and losses or as actions that will increase or reduce efficiency

Rights approach: It holds that any action that violates anyone's rights is unethical whether it is a positive sum game or even if majority benefits from the action to opposing a merger.

Social Issues in Mergers & Acquisitions

The social issues include matters like:

the name of the combined entity¬

the location of its headquarters¬

the composition of the combined board and most importantly,¬

who will lead the combined company after the closing of the transaction.¬

Some mergers are likely to lessen Competition & reduced competition in turn can lead to: Higher prices, reduced availability of goods or services, lower quality of products, and less innovation

Ethical Dilemmas in Business Mergers

- Disclosure by Target Company. The company being acquired is often called the target company. ...

- Unfriendly Takeovers. A company might decide to acquire a company that is not for sale. ...
- Confidentiality. ...
- Terminating Employees. ...
- Relocating Employees.
- Discrimination. One of the biggest ethical issues affecting the business world in 2020 is discrimination. ...
- Harassment. ...
- Unethical Accounting. ...
- Health and Safety. ...
- Abuse of Leadership Authority. ...
- Nepotism and Favoritism. ...
- Privacy. ...
- Corporate Espionage.

UNIT –II

DIFFERENT FORMS OF MERGERS

What is a Merger?

A merger refers to an agreement in which two companies join together to form one company. In other words, a merger is the combination of two companies into a single legal entity. In this article, we will look at different types of mergers that companies can undergo.

Types of Mergers

There are five basic categories or types of mergers:

1. **Horizontal merger:** A merger between companies that are in direct competition with each other in terms of product lines and markets
2. **Vertical merger:** A merger between companies that are along the same supply chain (e.g., a retail company in the auto parts industry merges with a company that supplies raw materials for auto parts.)
3. **Market-extension merger:** A merger between companies in different markets that sell similar products or services
4. **Product-extension merger:** A merger between companies in the same markets that sell different but related products or services

5. **Conglomerate merger:** A merger between companies in unrelated business activities (e.g., a clothing company buys a software company)

Horizontal Mergers

A horizontal merger is a merger between companies that directly compete with each other. Horizontal mergers are done to increase market power (market share), further utilize economies of scale, and exploit merger synergies.

Vertical Mergers

A vertical merger is a merger between companies that operate along the same supply chain. A vertical merger is the combination of companies along the production and distribution process of a business. The rationale behind a vertical merger includes higher quality control, better flow of information along the supply chain, and merger synergies.

Market-Extension Mergers

A market-extension merger is a merger between companies that sell the same products or services but that operate in different markets. The goal of a market-extension merger is to gain access to a larger market and thus a bigger client/customer base.

Product-Extension Mergers

A product-extension merger is a merger between companies that sell related products or services and that operate in the same market. By employing a product-extension merger, the merged company is able to group their products together and gain access to more consumers. It is important to note that the products and services of both companies are not the same, but they are related. The key is that they utilize similar distribution channels and common, or related, production processions or supply chains.

Conglomerate Mergers

A conglomerate merger is a merger between companies that are totally unrelated. There are two types of a conglomerate merger: pure and mixed.

- A **pure conglomerate merger** involves companies that are totally unrelated and that operate in distinct markets.
- A **mixed conglomerate merger** involves companies that are looking to expand product lines or target markets.

The biggest risk in a conglomerate merger is the immediate shift in business operations resulting from the merger, as the two companies operate in completely different markets and offer unrelated products/services.

RATIONALE FOR CORPORATE MERGERS

Some companies pursue a merger as a one-time opportunity that arises, whereas others make it an ongoing strategy they utilize to grow their business. Corporate mergers are also referred to as mergers and acquisitions because many times one of the companies involved purchases a majority control of the other and assumes a dominant role from a managerial standpoint after the deal is closed.

Combined Strength

Creating a larger company gives the combined entity more strength in the marketplace. Volume purchasing is one advantage. The larger entity purchases more of a given item than each company did by itself, so manufacturers give the combined company volume discounts.

Customer Acquisition

Merging allows a company to acquire customers quickly rather than taking the time and spending the money to get established in a new market. The strategic decision to expand across a region or even into another country is one reason mergers and acquisitions take place. Bank mergers are often motivated by a strategy of geographic expansion.

Retirement of Owner

Many acquisitions take place because the owner wants to retire and reap the rewards of all of his years of hard work building the company by selling it to another, larger company. He may

also elect to sell only a portion of his shares and keep the rest if he believes the company making the acquisition will further build the value of the business in the ensuing years.

Vertical Integration

From the stage of purchasing raw materials all the way to the finished product appearing on retail store shelves, a chain of transactions happens in which several companies play a role in creating the finished product and moving it through the distribution system. Along the way, each company earns a profit. A company may decide it will be more efficient and profitable to control the steps in the process itself. An oil refining company may decide to develop the capacity to drill for oil rather than purchasing the oil from a supplier. One way to quickly develop this capacity is to acquire a company that already has drilling rights, production equipment and a transportation infrastructure to deliver the oil to refineries.

Synergies

Just like individuals, companies have different relative strengths. When they join together, each can take advantage of the other's core competency. One company may have achieved excellent brand recognition in the marketplace but have products near the end of their life cycles with limited opportunity for sales growth. The other might be a newer company with an exciting and innovative product line ready to introduce, but limited marketing or distribution channels in place. Combined, they can quickly build the second company's sales by taking advantage of the first company's marketing strengths.

Pull Together a Fragmented Industry

Some industries are characterized as being fragmented, meaning there are a number of smaller companies all vying for market leadership. Individually, they may not have the brand strength or financial resources to achieve a position of dominance. A strategy of merging two or three of these smaller companies can create a more profitable combined entity because duplicated staff functions can be eliminated and production capacity can be shared. For example, one customer service staff can handle all of the volume for the combined entity that formerly required two or three separate customer service groups.

The preliminary objective of setting up a business is to create value. Value creation can have variant meanings for shareholders, owners or stakeholders. An owner may seek to create value for himself during the inception stage of his business by generating returns that not only surpass his capital costs but also meet his target return on investment. As the business prospers, the company also needs to consider the expectations of other stakeholders for value creation. Strategically, the company strives to meet its customers' value expectations, hence accomplishes higher sales of its goods & services.

For instance, in an upcoming technology-driven venture like robotics, the value creation can be obtained by investing in research & development, focusing on innovation or merging with existing technology firms. Such strategies enable businesses to provide their customers with the latest products having a myriad of advanced features.

In other sectors like retail, customers seek consistent quality products, innovative processes, and an enhanced 'brand experience.' Hence, the company's value can be driven by factors like market presence, revenue growth, brand strength, productivity, and stability of margins. In operational terms, the business also needs to meet stakeholder expectations, employees concerns, regulators, and society at large. By creating value, the company deploys its financial and human capital in a more efficient manner, thus, achieves profitable and sustainable growth.

Though Mergers and Acquisitions are a robust tool in a CEO's strategic toolkit, yet value creation through mergers and acquisitions still remains a mirage.

Primary Reasons for failure in value creation through M&A

Indian companies would have been in a better state if they had not taken the path of Merger and Acquisition for organic-growth. Around 75% of M&A transactions made by the local firms have failed to create substantial value from the deals; moreover, 59% of the acquirers have indeed destroyed value within one year of closing the deal.

As per the legal experts, the Indian companies do not accentuate on integration issues before finalizing an M&A deal. However, the acquirers around the world persistently insist on an integration plan and a detailed synergy assessment prior to sealing the deal. Besides, firms lose interest in the acquired assets and do not refurbish them post-transaction, which affects the value of the acquirer.

Generally, it takes 12 months after M&A deal completion to determine the success of the transaction and check if it will add any value for the buyer's shareholders or not. The most common reasons that lead to the failure in **value creation through mergers and acquisitions** are cultural disparity and post-integration while there are other factors as well. Let us look at the other reasons:

- **Inadequate Involvement of the Owner-** Some business leaders may take an active part in the process of Merger and Acquisition, but plenty of the owners count on experts to handle most of the work. During the negotiations of M&A transactions, many professionals oversee the major issues. It creates problems for the business owners to smoothly function as they do not get an insight into the existing circumstances and expectations post-transaction for being out of the picture.
- **Integration Impediments-** Merger and Acquisition is far easier on papers than merging the operation & culture in actual. Things may get topsy-turvy if there is no concrete plan for the integration. Also, a company faces integration obstacles due to miscommunication amongst the middle to higher management. An uncertainty Merger or Acquisition disrupts the company's productivity and efficiency. Therefore, such integration must be evaluated beforehand and handled diligently.
- **Inaccurate Data and Valuation Errors**- Overly strategical evaluation and lofty projections are common reasons for the deal's demise. Granted, the parties do everything possible to do an approaching deal. Regrettably, this often shows that the financial matters are certainly calculated and analyzed rather "innovative" to make them as attractive as possible. Although it is evident that the parties seek to anticipate the numbers assuming the best-case scenario, however, the reality is far below than what was presented prior to the deal.
- **Resource Limitation-** A newly formed entity requires plenty of resources, both financial and human, to overcome the challenges of integrating two different cultures and companies after M&A. The company ought to update policies, invest in creating extra real estate space, which requires a bit of time and money. Thence, the company must consider and plan beforehand; however, that is not always the case.
- **Unfavourable Economic Factors-** Even the best business plans can go wrong if there is a sudden change in the economy, which affects stock prices and interest rates. A negative

economic climate will certainly hinder the success of a Merger and Acquisitions, regardless of how well they were expected to perform.

- **Lack of Strategy and Planning-** Mostly, the issues mentioned above are responsible for an M&A deal's failure, but that can be avoided with proper planning, creation and execution of a coherent strategy. The central focus is on getting the M&A deal closed, but not enough attention is paid on the aftermath. Such lack of foresight is the reason that even the smallest issues get in the way of the deal's true potential.

Efficient ways for Successful Value Creation through Mergers and Acquisitions

Around 34% of acquirers' claim that value creation is a priority on the day of closing the deal, however, 66% of dealmakers said that value creation must be a priority right from the start. Some acquirers only emphasize upon integrating the hard tangible assets such as accounting, financial, and operations systems, during M&A to achieve the desired value. Besides, they neglect the soft and equally important intangible assets like people and culture. The root cause of failure in value creation through Mergers and Acquisitions is the acquirers' inability to create synergy, selecting inappropriate target companies, paying too high a premium, and ineffective integration.

Things to consider for successfully creating value through M&A:

- With a wise selection of targets and effective implementation of acquisitions, one can achieve synergy and create value. The difference in the sizes of an acquiring company and the target company affects value creation. In case the target company is much smaller than the acquiring company, then it shall not affect value creation. On the other hand, if the target company has same capabilities as an acquiring company, an opportunity for synergy creation exists. If the difference narrows and value creation increases, integration often becomes a problem. It further leads to value loss, even if the companies involved are of similar size.
- The acquirers need to stay true to the strategic intent. Companies must approach Merger and Acquisition deals as part of a clear strategic vision and align it to the long-term objectives for the business. 86% of acquirers said that their latest acquisitions had created a significant value as it was a part of a broader portfolio review than merely an opportunity. Thus, companies

must bring a more strategic lens to M&A planning and understand where the business requires strengthening.

- Companies must have a clear **blueprint** containing all the elements of the value creation plan. Acquirers should ensure to conduct a thorough due diligence across all areas of the business for a successful value creation through Mergers and Acquisitions. Consider some factors like how each element of the value creation process supports your business model, operating model, technology plans and synergy delivery. Reportedly, 79% of acquirers did not have an integration strategy in place when signing an M&A deal, while 63% did not have a technology plan.
- Lastly, prioritize and fix cultural differences at the start of a deal. Human capital and talent management majorly influence how companies can deliver value. 82% of companies said a large value was destroyed in their latest acquisition and lost more than 10% of employees after the transaction took place. Businesses should invest more time and resources in the process of M&A transactions to succeed. Over two-thirds of the companies said that their latest M&A deal subsequently created a significant value as they had an integration strategy in place while signing. The acquirer must have an ability to bring different cultures together, which is a key factor in determine the success and failure of the deal.

A successful M&A process utilises these best practices:

- Thorough evaluation and due diligence of the target companies
- Strategic interest of the potential synergies
- Resource and cultural management;
- Solid communication strategy which helps to facilitate a change in management and raise value creation.

Conclusion

The concept of value creation through mergers and acquisitions depends on how you manage the process from merger preparation to post-merger integration. The process includes thorough assessment of whether a deal is worth pursuing or not, robust strategy and M&A methodology. Acquirers must have their value creation plan together in place prior to indulging in a deal and cultural issue which might hamper the actual value in their long-term strategy.

TAX CONSIDERATIONS AROUND MERGERS AND ACQUISITIONS

A merger or acquisition may be a tax-free **I.R.C. §368** reorganization or a taxable transaction under the principles of **I.R.C. §1001**. There may also be state tax consequences from some types of M&A transactions.

The potential tax consequences of a merger or acquisition to a business entity and its owners – and the complexity of the tax principles involved – dictate that one of the most critical aspects of structuring such a transaction is tax planning.

The tax department provides the strategic analysis that informs and guides M&A decisions and structuring. This includes reviewing the following through the lens of tax liability and the impact on the cash flow and value of the merged business:

What is a corporate reorganization and how is it treated for federal income tax purposes?

As defined in **I.R.C. §368**, a corporate reorganization is a term of art used for federal income tax purposes and encompasses various types of transactions, including:

- Acquisitions of assets or stock of one corporation by another
- Readjustments of capital structure of a single corporation
- The division of a single corporation into two or more entities

A reorganization must meet several statutory and common law requirements in order for the participating corporations and their shareholders to avail themselves of favorable tax treatment.

What are the tax consequences to the target corporation in an otherwise qualifying reorganization?

An acquired corporation recognizes no gain or loss upon an exchange pursuant to a plan of reorganization if it receives solely stock, securities, or both in a corporation that is a party to the reorganization – and the acquired corporation distributes such stock, securities, or both to its shareholders.

If an acquired corporation receives other property (boot) in the reorganization, it recognizes gain to the extent of the boot if the boot is not distributed to shareholders of the acquired corporation.

M&A FINANCING

M&A financing is the process of raising money to fund mergers and acquisitions. The primary sources of M&A financing are equity financing and debt financing. Companies may also use their existing cash reserves.

A key consideration in M&A financing is to ensure the capital provided is sensitive to the company's operating cash flows. For example, if the company is raising debt financing, it should have adequate coverage to fulfill the interest obligations and eventually repay the debt.

Another aspect of M&A financing is control over the combined organization. Equity financing could lead to a loss of control if the target is a large proportion of the combined company. Depending on their finances and their willingness to exercise control, companies could use any one or a mix of these sources to fund M&A transactions.

- M&A financing involves raising funds to finance M&A transactions. Companies may use equity financing, debt financing, or a mix of the two
- M&A financing needs to be sensitive towards the operating cash flows of the combined company. Unlike equity financing, debt financing leads to cash outflows (for interest payments and repayment of the debt)
- Typically, companies incur transaction fees when raising capital. Transaction fees are a use of funds and need to be considered as part of the total cost of the deal.
- As part of equity financing, companies may sell equity shares and raise cash for M&A financing. Alternatively, they can use their stock as consideration instead of cash
- Debt financing is raising debt for M&A financing. In times of low-interest rates, debt is a cheaper source of M&A financing when compared to equity financing

Types of M&A Financing

Equity Financing

Equity financing, in the context of M&A financing, can mean two things: 1) The company selling its equity to raise cash to fund the deal, and 2) A stock swap or the company using equity as a currency (instead of cash) to acquire the shares of the target company. A stock swap or the exchange of one company's equity for another helps the acquirer preserve cash.

Debt Financing

Debt financing is raising money from lenders on the condition of repaying the borrowed amount later. For startups and less mature companies, debt financing is harder to obtain when compared to equity financing. However, in times of low-interest rates, it is a comparatively cheaper source of funding.

In M&A financing, the amount of debt financing depends on the combined firm's consolidated debt capacity. It is typically based on an EBITDA multiple (e.g., a Debt/EBITDA of 6x would mean the company can get debt of up to 6 times its EBITDA). The interest rate charged depends on the consolidated risk of the combined entity. Debt financing can adversely affect the borrowing company's credit ratings.

	Positives	**Negatives**
Equity Financing	Does not increase leverage Good if a company's share valuation is high Does not need to be repaid	More expensive than debt Can lead to loss of control Net income will increase due to synergies, but the EPS might fall if management have to issues lots of shares
Debt Financing	Cheaper than equity Does not reduce control Shareholders enjoy all the benefits of synergies	Limit on the amount of financing that can be raised Can result in a credit rating downgrade Cash drain to pay interest and repay the debt

MERGER NEGOTIATIONS

When it comes to mergers and acquisitions, a friendly negotiation isn't what initially comes to mind. In reality, most mergers and acquisitions are negotiated in a friendly environment. It may be hard to believe because of the terms "takeovers" "hostile takeovers", but it is the reality.

Differences in Merger Negotiations

Usually, in buyer-initiated takeovers, the process begins when one firm's management contacts the management of the target company. This is often done with the help of the investment bankers of each company.

On the other hand, seller-initiated deals are done by hiring an investment banker. The investment banker will then contact the prospective bidders. If the contacted prospective bidders are interested, they will sign a confidentiality agreement and agree not to make an unsolicited bid. Additionally, potential bidders may also receive nonpublic information.

Next, the seller and their investment bankers can conduct an auction if they choose. Or they can also negotiate with just one bidder if they think they can reach an agreeable price.

When it comes to auctions, these can be conducted formally or in a less formal manner. Formal auctions usually have specific bidding rules established by the seller.

The management team of both the buyer and the seller must keep their respective board of directors up-to-date with any information and progress of the negotiations. This is because the board of directors usually has to approve of the mergers.

Examples of Different Merger Agreements

If the process is smooth-sailing from start to finish, a quick merger agreement commences. Usually, deals with this high of a price aren't done in a quick manner. However, the quick meeting between the corporate minds and management of both firms leads to a quick and friendly deal.

This doesn't mean that quick and friendly deals are often the best way to go, however. It depends on different circumstances. Ultimately, it was found that the buyer did not do his homework and

the seller did a fantastic job of fulfilling the buyer's desires to make a quick sale at a higher price.

At a certain point, speed can help ward off unwanted bidders. But it can also open the possibility of working against close scrutiny of the transaction.

Negotiations Breakdown

There are also instances where friendly negotiations may break down. It leads to an end to the deal or a hostile takeover.

For example, let's take Moore Corporation's tender offer for Wallace Computer Service Inc. In this contract, talks in the area of business types and printing business between two archrivals have been going on for five months.

Time period of Negotiation

They were called after just five months of negotiations and it resulted in a hostile offer of $1.3 billion. Back in 2003, Moore and Wallance reached an agreement for the acquisition which led to the formation of Moore Wallace. A year passed, and with MooreWallace, RR Donnelley merged.

There are also instances where the target immediately opposes the bid and the transaction will lead to a hostile one quickly. In 2003, the takeover battle between Oracle and PeopleSoft immediately led to a very hostile bid.

It is one of the most infamous takeovers because it was unusual. Because of its protracted length, the takeover contest was considered unusual. A year before PeopleSoft finally capitulated and accepted a higher Oracle bid, the takeover battle continued.

Material adverse change clauses are usually included in most merger agreements. Where there is a major change in circumstances that would ultimately change the value of the deal, either party may be allowed to withdraw from the deal.

UNIT- III

TAKEOVERS

Tender Offer?

A tender offer is a proposal that an investor makes to the shareholders of a publicly traded company. The offer is to tender, or sell, their shares for a specific price at a predetermined time. In some cases, the tender offer may be made by more than one person, such as a group of investors or another business. Tender offers are a commonly used means of acquisition of one company by another.

A tender offer is a conditional offer to buy a large number of shares at a price that is typically higher than the current price of the stock. The basic idea is that the investor or group of individuals making the offer are willing to pay the shareholders a premium – a higher than market price – for their shares, but the caveat is that they must be able to buy a specified minimum number of shares. Otherwise, the conditional offer is canceled. In most cases, those that extend a tender offer are looking to acquire at least 50% of the company's shares in order to take control of the company.

How a Tender Offer Works

Because the party looking to buy the stocks is willing to offer the shareholders a significant premium over the current market price per share, the shareholders have a much greater incentive to sell their shares.

It's also important to note that tender offers can be made and carried out without the target company's board of directors giving approval for the shareholders to sell. The individual(s) looking to acquire the shares approach the shareholders directly. If the target company's board does not approve of the deal, then the tender offer effectively constitutes a "hostile takeover" attempt.

Governing law

United States

General

In the United States of America, tender offers are regulated by the Williams Act. SEC Regulation 14E also governs tender offers. It covers such matters as:

1. the minimum length of time a tender offer must remain open
2. procedures for modifying a tender offer after it has been issued
3. insider trading in the context of tender offers
4. whether one class of shareholders can receive preferential treatment over another

Required disclosures

In the United States, under the Williams Act, codified in Section 13(d) and Section 14(d)(1) of the Securities Exchange Act of 1934, a bidder must file Schedule TO with the SEC upon commencement of the tender offer. Among the matters required to be disclosed in schedule TO are: (i) a term sheet which summarizes the material terms of the tender offer in plain English; (ii) the bidder's identity and background; and (iii) the bidder's history with the target company. In addition, a potential acquirer must file Schedule 13D within 10 days of acquiring more than 5% of the shares of another company.

Tax consequence

The consummation of a tender offer resulting in payment to the shareholder is a taxable event triggering capital gains or losses, which may be long-term or short-term depending on the shareholder's holding period.

DEFENSIVE TACTICS

In M&A transactions, a defense mechanism (also known as a defense strategy) is any set of procedures that are employed by a target company to prevent a **hostile takeover**. A hostile takeover is a type of acquisition in which a bidder takes over a target company without the consent, and against the wishes, of the management or board of directors of the target. Hostile

takeovers are executed through the acquisition of a controlling interest in the target company by a bidder.

The target company must determine how to prevent a hostile takeover with approaches that either prepare for the risk of acquisition or react to the prospective buyer's takeover efforts. There are several hostile takeover defense strategies that target companies can use to prevent unwanted acquisitions.

Differential voting rights

This preemptive defense strategy involves establishing stocks with differential voting rights, meaning shareholders have fewer voting rights than management. If shareholders must own more shares to cast votes, a takeover becomes a more costly endeavor.

Pros: This approach gives executive employees the most powerful influence over voting results.

Cons: A decrease in voting rights may upset shareholders.

Employee stock ownership program

Another preemptive defense strategy is to create a tax-qualified plan that grants employees more substantial interest in the company. The idea is that employees are more likely to vote for management rather than support a hostile buyer.

Pros: This strategy can increase employee loyalty and satisfaction.

Cons: Hostile buyers can still persuade shareholders in a proxy fight.

Poison pill

Likely the most famous defense against hostile takeovers, the poison pill strategy aims to make takeovers expensive enough to deter buyers. It's officially known as a shareholder rights plan and allows current stakeholders to purchase new shares at a discounted price. The plan excludes the hostile bidder from the discounted price, making it difficult for the buyer to obtain a controlling share without a steep cost.

Pros: The poison pill strategy can discourage current hostile buyers and future takeovers, or at least grant the target company more favorable terms for the acquisition.

Cons: This approach is unlikely to deter persistent or knowledgeable acquirers, and may cause significant damage to the company if implemented incorrectly.

Pac-Man defense

Target companies may choose to avoid a hostile takeover by buying stock in the prospective buyer's company, thus attempting a takeover of their own. As a counter strategy, the Pac-Man defense works best when the companies are of similar size.

Pros: Turning the tables puts the original buyer in an unfavorable situation.

Cons: This strategy requires substantial resources and is extremely costly for the organization and its shareholders.

Golden parachute

In the event of a merger or acquisition, a golden parachute contract guarantees substantial benefits for major executives of the target company who are let go as a result of the deal. These contracts can sometimes deter hostile bidders, but at the very least provide security for management.

Pros: Companies can combine this approach with other strategies to further discourage hostile buyers.

Cons: This is a controversial strategy that can harm the company's reputation.

Crown jewel

Employing a crown jewel defense means selling the company's most profitable assets, reducing its attractiveness to unwanted buyers. This is a risky strategy, as it destroys the company's value. As such, many companies will seek a friendly third-party company, often referred to as a white knight, to buy their assets. Once the hostile buyer drops the bid, the target company can buy its assets back from the strategically chosen third party.

Pros: The target company becomes a less attractive acquisition.

Cons: This is a high-risk defense. Without a white knight, the company will lose its most valuable assets.

Leveraged Buyouts

A leveraged buyout (or LBO, or highly- leveraged transaction (HLT), or "bootstrap" transaction is the acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition and the assets of the company being acquired are used as collateral for the loans in addition to the assets of the acquiring company. The outsider‟s money is used because of lack of cash or to make use of other people‟s money to expand one‟s capability to make larger acquisitions. A typically transaction involves the setup of an acquisition vehicle that is jointly funded by a financial investor and management of the target company. Often the assets of the target company are used as collateral for the debt. Typically, the debt capital comprises of a combination of highly structured debt instruments including pre-payable bank facilities and / or publicly or private placed bonds commonly referred to as high-yield debt. The term „Leveraged‟ signifies a significant use of debt for financing the transaction. The term „Buyout‟ suggests the gain of control of a majority of the target company‟s equity.

What is a leveraged buyout (LB0)?

• In an LBO, a small group of investors, normally including management, buys all of the publicly held stock, and hence takes the firm private.

• Purchase often financed with debt.

• After operating privately for a number of years, investors take the firm public to "cash out

The three main characteristics of LBOs

1. High debt

2. Incentives

3. Private ownership

Key Participants

The term "financial sponsor" refers to traditional private equity (PE) firms, merchant banking divisions of investment banks, hedge funds, venture capital funds and so on…

PE firms, hedge funds, and venture capital funds raise the vast majority of their investment

capital from third-party investors, which include public and corporate pension funds, insurance companies.

Leveraged Buyout Analysis Steps

Follow the steps for Leveraged Buyout Analysis

1. **Assumptions of Purchase Price**

The first step is making assumptions on the purchase price, debt interest rate, etc.

2. **Creating Sources and Uses of Funds**

With the information of purchase price, interest, etc., then a table of Sources and Uses can be created. Uses reflect the amount of money required to effectuate the transaction. Sources tell us where the money is coming.

3. **Financial Projections**

In this step, we project financial statements, i.e., Income Statement, Balance Sheet, usually for the period of 5 years

4. **Balance Sheet Adjustments**

Here, we adjust the Balance Sheet for the new Debt and Equity.

5. **Exit**

Once and adjustments are made, assumptions about the private equity firm's exit from its investment can be made.

A general assumption is that the company will be sold after five years at the same implied EBITDA multiple at which the company was purchased (Not necessary)

6. **Calculating Internal Rate of Return (IRR) on the Initial Investment**

There is a reason why we calculate the sale value of the company. It allows us to also calculate the value of the private equity firm's equity stake, which we can then use to analyze its internal rate of return (IRR).

IRR is used to determine; how much you are going to get back on your initial investment.

Key characteristics of an LBO candidate (Target Company)

- A company from a Mature industry
- A clean balance sheet with no or low amount of outstanding debt
- Strong management team and potential cost-cutting measures
- Feasible exit options
- Strong competitive advantages and market position
- Possibility of selling some underperforming or non-core assets

DISINVESTMENT

A divestiture (or divestment) is the disposal of company's assets or a business unit through a sale, exchange, closure, or **bankruptcy**. A partial or full disposal can happen, depending on the reason why management opted to sell or liquidate its business' resources. Examples of divestitures include selling intellectual property rights, corporate acquisitions and mergers, and court-ordered divestments.

The aim of disinvestment is to facilitate re-allocation of funds or resources to better use or monetise assets. Disinvestment also helps in lowering debt and restructuring of business. The process helps in increasing the return on investment.

Reasons behind a divestiture

There are many reasons why a corporation may decide they need to sell an asset, a business unit, or the entire company. Some of the most common reasons include:

1. To sell off redundant business units

Most companies decide to sell off a part of their core operations, if they are not performing, in order to place more focus on the units that are performing well and are profitable.

2. To generate funds

Selling a business unit for cash is a source of income without a binding financial obligation.

3. To increase resale value

The sum of a company's individual asset liquidation value exceeds that of the market value of its combined assets, meaning there is more gain realized in liquidation than there is in retaining existing assets.

4. To ensure business survival or stability

Sometimes, companies face financial difficulties; therefore, instead of closing down or declaring bankruptcy, selling a business unit will provide a solution.

5. To comply with regulators

A court order requires the sale of a business to improve market competition.

How is a divestiture carried out?

Companies divest in order to efficiently manage their asset portfolio. There are multiple options to go about the process and effectively execute the disposition.

1. Partial sell-offs

Selling a business subsidiary to another company to raise capital and apply the funds to more productive core units instead.

2. Spin-off demerger

A business strategy wherein a company's division or unit is separated and made into an independent company.

3. Split-up demerger

When a company splits-up into one or more independent companies, and consequently, the parent company is dissolved or ceases to exist.

4. Equity carve-out

A corporate approach wherein the company sells a portion of its wholly-owned subsidiary through initial public offerings or IPOs and still retains full management and control.

BUY BACK OF SHARES – COMPANIES ACT, 1956

Section 77A

Company limited by shares may not purchase its own shares as this would amount to an unauthorized reduction of Capital.

A company may purchase its own shares or other specified securities through “buy-back" out of -

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of any shares or other specified securities

No company shall purchase its own shares or other specified securities unless such buy-back is authorized by its articles and a special resolution has been passed in general meeting of the company authorizing the buy-back.

Objective of Buy – Back

The reasons for buy- back may be one or more of the following:

1. To improve earnings per share
2. To improve return on capital, return on net worth and to enhance the long term shareholder value
3. To provide an additional exit route to shareholders when shares are under valued or are thinly traded
4. To enhance consolidation of stake in the company
5. To prevent unwelcome takeover bids
6. To return surplus cash to shareholders
7. To achieve optimum capital structure
8. To support share price during periods of sluggish market conditions
9. To service the equity more efficiently.

Authority and Quantum of Buy back of Securities

1. Authority in the Articles – Buyback of securities should be authorized by the Articles of Association – Section 77A (2)(A)

2. Board resolution and quantum of buy back – By passing a resolution, the Board can authorize the buy – back of securities not exceeding 10% of the total paid – up equity capital and free reserves of the company. Section 77A (2)

3. Shareholders' resolution and quantum of buy – back – By passing a special resolution, the buyback of securities is or less than twenty-five per cent of the total paid-up capital and free reserves of the company. Section 77A (2)(b)& (c)

4. Maximum Quantum of buy back – A company cannot buy back more than 25% of its total paid – up capital and free reserves. Section 77A (2)(c)

5. Further offer of buyback - No offer of buy-back shall be made within a period of three hundred and sixty-five days reckoned from the date of the preceding offer of buy-back, if any. Second proviso to Section 77A(2)

Conditions to be fulfilled and obligations for Buy back of Securities

1. Only fully paid up securities qualify for buy back – Section 77A (2)(e). Fully paid up securities, even if quoted below par on the stock exchange qualify for buy back.

2. After buy back, the company should have a debt- equity ratio not exceeding 2:1 - Section 77A (2)(d)

3. Where buy back is made out of free reserves, the company should transfer to the capital redemption reserve account [Section 80(1)(d)], a sum equal to nominal amount of the shares bought back and the details of such transfer and should be disclosed in the balance sheet - Section 77AA

4. Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make further issue of the same kind of shares including allotment of further shares under section 81(1)(a) or other specified securities within a period of six months

except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares. Section 77A (8)

5. No buy back of securities should be undertaken while a petition for amalgamation is pending

6. No issue of any securities including bonus shares should be made till the closure of offer of buy back

7. Promoters or persons acting in concert should not deal in the securities of the company while the buyback offer is open.

Restriction on Buy back

1. A company should not buy back its securities if default subsist in repayment of deposits or interest payable thereon, or in redemption of debentures or preference shares or repayment of any term loan or interest payable to any financial institutions – Section 77B(1)(C)

2. Buy back should not be made if a company has defaulted in relation to preparation and filling of its annual return – Section 77B(2)

3. Buy back should not be made in event of any default in relation to payment of dividend to any equity or preference shareholders - Section 77B(2)

4. Buy back should not be made in the event of default in preparation of annual accounts - Section 77B(2)

5. Buy back should not be made through any subsidiary company including its own subsidiary companies or through any investment company or group of investment companies - Section 77B(1)(a)&(b)

EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)

An Employee Stock Ownership Plan invests in the employer's company. The goal of the plan is to align the interests of the employees with the interests of the company's shareholders. By giving the employees a stake in the company, the employees move from being only workers to being owners of the company. The plans motivate employees to do what is best for the shareholders, since they are shareholders as well.

Companies with a majority employee-ownership are referred to as employee-owned corporations and are similar to worker cooperatives. The difference with an employee stock ownership plan, as compared to a worker corporative, is that with an ESOP the company's capital is not evenly distributed. Senior employees are allocated more shares than newly hired employees, and therefore, the latter exercise less voting power during shareholder meetings.

How an ESOP works

When a company wants to create an Employee Stock Ownership Plan, it must create a trust in which to contribute either new shares of the company's stock or cash to buy existing stock. These contributions to the trust are tax-deductible up to certain limits. The shares are then allocated to all individual employee accounts. The most common allocation formula is in proportion to compensation, years of service, or both. New employees usually join the plan and start receiving allocations after they've completed at least one year of service.

The shares in an ESOP allocated to employees must vest before employees are entitled to receive them. Vesting, in this case, refers to the increasing rights that employees receive on their shares as they accumulate seniority in the organization.

When employees who are members of the ESOP leave the company, they ought to receive their stock. Private companies are required to buy back the departing employee's shares at fair market value within 60 days of the employee's departure. Private companies must have an annual stock valuation to determine the price of the shares. Where some longstanding employees are exiting the company, and the share price has accumulated substantially, the company needs to make certain that is has enough money to pay for all the share repurchases.

Benefits of an ESOP

1. Tax benefits for employees

One of the benefits of Employee Stock Ownership Plans is the tax benefit that employees enjoy. The employees do not pay tax on the contributions to an ESOP. Employees are only taxed when they receive a distribution from the ESOP after retirement or when they otherwise exit the company. Any gains accumulated over time are taxed as capital gains.

2. Higher employee engagement

Companies with an ESOP in place tend to see higher employee engagement and involvement. It improves awareness among employees since they are given the opportunity to influence decisions about products and services. Employees can see the big picture of the company's plans in the future and make recommendations on the kind of direction the company wants to take. An ESOP also increases employee trust in the company.

3. Positive outcomes for the company

Employee stock ownership plans not only benefit the employees but also result in positive outcomes for the company. According to the National ESOP Comparison Study conducted by Rutgers University, the adoption of ESOPs resulted in a 2.4% increase in the annual sales growth, annual employment growth 2.3%, and increased the likelihood of company survival. An improved organizational performance increases the share price of the company and ultimately, the balance in each employee's ESOP account.

Drawbacks of an ESOP

1. Lack of diversification

Employees who are members of ESOP concentrate their retirement savings in a single company. This lack of diversification is against the principle of investment theory that advises investors to invest in different companies, industries, and locations. Worse still, the employees lock their savings into the same company that they depend on for salaries, wages, insurance, and other benefits. If the company collapses, then the employee faces the risk of losing both their income and their savings.

2. Limits newer employees

An Employee Stock Ownership Plan is designed in a way that limits benefits to newer employees. Employees who enrolled in the plan earlier benefit from the continuous contribution to the plan, giving them a higher voting power. This is, however, different for newer employees who, even in stable companies, may not accumulate as much in savings as the longstanding employees. Therefore, newer employees are given limited opportunity to participate in crucial decisions during annual general meetings and other forums.

3. Dilutive

Share ownership in an Employee Stock Ownership Plan is dilutive, meaning it reduces the percentage of ownership that each share holds. As more employees join the company, they are allocated shares to their accounts in the plan. This reduces the overall percentages of the shares held by older members in the plan. The dilution also affects voting power, since employees who hold high voting power, owing to their higher number of shares, end up with reduced voting powers after new members are admitted.

CREEPING AQUISITION

Creeping acquisitions refer **to the purchase of company shares by its investors** (usually, promoters or shareholders with significant holdings) over a number of small transactions, so as to increase the investors' stake in the company by an economically significant amount without requiring any disclosure.

What is a creeping tender offer?

A creeping tender offer is **the gradual accumulation of a target company's shares**, with the intent of acquiring control over the company or obtaining a significant voting block within it. A creeping tender offer is conducted through the purchase of shares on the open market, rather than through a formal tender offer.

UNIT IV

REGULATIONS FOR MERGERS AND TAKEOVERS IN INDIA

Regulations For Mergers And Takeovers In India

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

(I) 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.

(3) 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 some what in an application seeking compromise or arrangement.

(4) 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.

(5) 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.

(6) 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.

(7) 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.

(II) The Competition Act ,2002

Following provisions of the Competition Act, 2002 deals with mergers of the company:-
(1) Section 5 of the Competition Act, 2002 deals with “Combinations” which defines combination by 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.

(2) 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.

(III) 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.

(IV) SEBI Take over Code 1994

SEBI Takeover Regulations permit consolidation of shares or voting rights beyond 15% up to 55%, provided the acquirer does not acquire more than 5% of shares or voting rights of the target company in any financial year. [Regulation 11(1) of the SEBI Takeover Regulations] However, acquisition of shares or voting rights beyond 26% would apparently attract the notification procedure under the Act. It should be clarified that notification to CCI will not be required for consolidation of shares or voting rights permitted under the SEBI Takeover Regulations. Similarly the acquirer who has already acquired control of a company (say a listed company), after adhering to all requirements of SEBI Takeover Regulations and also the Act, should be exempted from the Act for further acquisition of shares or voting rights in the same company.

(V) 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.

(VI) 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”.

(VII) Stamp duty

Stamp act varies from state to State. As per Bombay Stamp Act, conveyance includes an order in respect of amalgamation; by which property is transferred to or vested in any other person. As per this Act, rate of stamp duty is 10 per cent.

SEBI GUIDELINES FOR TAKEOVERS

SECURITIES EXCHANGE BOARD OF INDIA NOTIFICATION MUMBAI, the 28th January, 2009 Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2009.

In exercise of the powers conferred by Section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board hereby makes the following regulations to amend the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, namely:- 1. (i) These regulations may be called the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2009. (ii) These regulations shall come into force on the date of their publication in the Official Gazette. 2. In the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 – Report this ad (i) after regulation 8, the following regulation shall be inserted, namely:-

Disclosure of pledged shares.

8A. (1) A promoter or every person forming part of the promoter group of any company shall, within seven working days of commencement of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2009, disclose details of shares of that company pledged by him, if any, to that company.

(2) A promoter or every person forming part of the promoter group of any company shall, within 7 working days from the date of creation of pledge on shares of that company held by him, inform the details of such pledge of shares to that company.

(3) A promoter or every person forming part of the promoter group of any company shall, within 7 working days from the date of invocation of pledge on shares of that company pledged by him, inform the details of invocation of such pledge to that company.

(4) The company shall disclose the information received under subregulations (1), (2) and (3) to all the stock exchanges, on which the shares of company are listed, within 7 working days of the receipt thereof, if, during any quarter ending March, June, September and December of any year.

SEBI GUIDELINES FOR BUYBACK FOR SHARES

SEBI guidelines for buyback for shares are as follows: (a) Notice of special resolution (b) Buying from Members through Tender offer (c) Buyback through Stock Exchange.

(a) Notice of special resolution:

The notice of special resolution to be passed by the members should contain explanatory statement giving details of the buy back deal as prescribed in Schedule I of SEBI Regulations.

(b) Buying from Members through Tender offer:

Under this method, the maximum price at which the company intends to buy back the shares should be indicated in the notice of the general meeting. If the promoters intend to offer their shares for buy back, details should be given in the notice of the general meeting. The company should make a public announcement in at least one English National Daily, One Hindi National Daily and One regional newspaper daily, all with wide circulation giving details prescribed in Scheduled II of SEBI Regulations.

The public announcement will mention the 'specified date' for the purpose of determining the names of shareholders to whom letters of offer shall be sent. Draft offer letter giving prescribed details should be submitted to SEBI along-with prescribed fees, at least 21 days before dispatch of letters of offer to shareholders. Offer for buy back will remain open for minimum 15 days and maximum 30 days.

Letters of offer should be sent to the members well in advance so as to reach them before the opening date of the offer. If the acceptances by the shareholders are more than the number of shares offered to them for repurchase, the actual buy back will be on proportionate basis. The company shall have to open and maintain an escrow account with prescribed amount as deposit. Within 15 days of closure of offer for buy back, payment should be made or regret letters should be sent to the shareholders.

(c) Buyback through Stock Exchange:

In case of buy back of shares through stock exchange route, special resolution of members should prescribe maximum price at which shares can be bought and the buy backs shall not be made from promoters or persons having control in the company. Such persons will not deal in shares in stock exchanges when offer for buy back is open.

The company should appoint a merchant banker. Public announcement should be made at least 7 days prior to commencement of buy back. A copy of public announcement is to be filed with SEBI along-with prescribed fee within 2 days of such announcement.

Companies buying back via stock exchange route must disclose purchases daily. Details of shares purchased every day should be informed to the stock exchanges. Payment will be made as per rules of trading in the stock exchanges.

Other Guidelines:

(a) The company will make true and full disclosure in the letter of offer and the public announcement.

(b) Bonus shares will not be announced when the buy- back offer is open.

(c) All payments will be made only by cash/cheque.

(d) Buy- back offer will not be withdrawn after public announcement.

(e) Locked-in-shares will not be bought back.

(f) The details regarding number of shares bought, price, total amount invested in buy back, details of shareholders from whom more than 1% of the total shares were bought and the consequent change in the capital structure.

SEBI GUIDELINES FOR ESOP

The Securities and Exchange Board of India (Sebi) has notified the Sebi (Share Based Employee Benefits and Sweat Equity) Regulations, 2021. These new regulations have merged the erstwhile Sebi (Issue of Sweat Equity) Regulations, 2002, and Sebi (Share Based Employee Benefits) Regulations, 2014.

A major change in the new regulations is the change in the definition of “employee" who is covered under the Esop (employee stock option plan) framework. Employee now includes non-permanent employee of a company, so long as he/she works “exclusively" for such a company. This means companies can now issue Esops to employees on fixed-term contracts, or those on probation, prior to confirmation of their employment. There is also greater clarity on the coverage of “non-executive directors" in the definition of employee, which means such officials can also be granted Esops. It is important to note that independent directors continue to be excluded, given the uniqueness of their role.

However, in the case of listed companies, one must remember that employees who are promoters or part of their promoter groups are still not permitted to be granted Esops.

The new regulations have also expanded its coverage to include employees of associate companies (those in which the issuing company has significant influence or is engaged with in a joint venture). Earlier regulations allowed only employees of holding and subsidiary companies to be issued Esops.

The new regulations have taken cognizance of health issues and hardship faced by employees and their families, specifically during the pandemic, and include certain relief measures. They have exempted the requirement of having a minimum vesting period of one year for Esops, in case of death or permanent disability of an employee. This ensures that the employees (or their family in the case of death) receive the intended benefit, even if the statutory minimum vesting period of one year has not elapsed, thus helping them cope financially, in times of difficulty or bereavement.

The SEBI (Share Based Employee Benefits) Regulations, 2014

a. Types of share based benefits

Listed companies may provide share based benefits to its employees under the following schemes:

1. Employee Stock Option Schemes (ESOS)

2. Employee Stock Purchase Schemes (ESPS

3. Stock Appreciation Rights Schemes (SARS)

4. General Employee Benefits Schemes (GEBS)

5. Retirement Benefit Schemes (RBS)

A company is required to satisfy any one of the following conditions with regard to the aforesaid schemes: the scheme is set up by the company or any other company in its group; or

- the scheme is funded or guaranteed by the company or any other company in its group; or

- the scheme is controlled or managed by the company or any other company in its group.

b. Employees covered under the Regulations

Regulation 2(1)(f) of the Regulations defines the term „employee" which is similar to the definition provided under the Companies Act, 2013.

C.Eligible employees

Compensation Committee determines eligibility of the employees to participate in the schemes under these Regulations. However, in case of a director nominated by any institution the following conditions shall have to be fulfilled:

The agreement to specify that any grants of option under these schemes can be accepted by the person, such grant shall not be renounced to the institution and conditions subject to which any fees, commission etc. can be accepted.

o The agreement is filed by the nominating institution with the company and the company also files the same with the stock exchanges.

o The director furnishes a copy of the agreement at the first board meeting in which he participates.

d. Scheme implementation and process

Compensation Committee A Company which intends to implement the aforesaid schemes requires constituting a Compensation Committee for administration and superintendence of the said schemes. The member of the said Committee shall be constituted with such members of the Board of Directors as prescribed for the Nomination and Remuneration Committee in terms of Section 178 of the Companies Act, 2013. Therefore, the Nomination and Remuneration Committee as constituted in terms of Section 178 may act as the Compensation Committee for the purpose of these Regulations if the Company does not decide to designate such other committee for this purpose.

However, if the implementation of the schemes is decided to be done through trust route, then the administrative power of the Compensation Committee is required to be delegated to the Trust formed under these Regulations.

The role of the Compensation Committee is to formulate detailed terms and conditions of the schemes including provisions specified by SEBI and to frame suitable policies and procedures in order to ensure compliance under Prohibition of Insider Trading Regulations and the Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 2003 by the Trust, company and its employees.

UNIT V

CROSS BORDER MERGERS

Cross border mergers are increasing significantly with the shrinking of the globe. Moreover, India is gradually climbing the ease of business rankings and is becoming a favored business destination. Such a Conducive economic environment has spurred the growth of cross border mergers.

MEANING OF CROSS BRODER MERGER & ACQUISITION

A cross border merger explained in simplistic terms is a merger of two companies which are located in different countries resulting in a third company. A cross border merger could involve an Indian company merging with a foreign company or vice versa.A company in one country can be acquired by an entity (another company) from other countries. The local company can be private, public, or state-owned company. In the event of the merger or acquisition by foreign investors referred to as cross-border merger and acquisitions.

Cross border merger will result in the transfer of control and authority in operating the merged or acquired company. Assets and liabilities of the two companies from two different countries are combined into a new legal entity in terms of the merger, While in terms of Coss border acquisition, there is a transformation process of assets and liabilities of local company to foreign company (foreign investor), and automatically, the local company will be affiliated.

TYPES OF CROSS BORDER MERGERS

The most popular types of mergers are horizontal, vertical, market extension or marketing/technology related concentric, product extension, conglomerate, congeneric and reverse.Recently, the concept of inbound and outbound mergers was also introduced in the Companies Act, 2013 as part of Section 234 of the Act.

Inbound M&A's

In this process foreign company mergers with or acquires an Indian company.

E.g. Daichii Acquiring Ranbaxy

Outbound M&A's

In this process an Indian company merger with or acquires a foreign company.

E.g. Tata steel Acquires Corus

MOTIVES FOR CROSS BORDER MERGERS AND ACQUISITIONS

The main motives for pursuing them are:

- Globalisation of financial markets
- access to new markets;
- market expansion and new knowledge,
- capabilities, and technology;
- complementary resources; and
- increasing market power
- increase the scale of production
- Technology share and innovation with reduced costs

MOTIVES OF CROSS MERGER AND ACQUISITION

1. Growth Orientation:
   To escape small home market, to extend market served, to achieve economy of scale.

2. Access to Inputs:
   To access raw materials to ensure consistent supply, to access technology, to access latest innovation, to access cheap and productive labor.

OPPORTUNITIES OF CROSS BORDER MERGERS & ACQUISITIONS

–Expansion of markets

– Geographic and industrial diversification

– Technology transfer

– Avoiding entry barriers & Industry consolidation

– Tax planning and benefits

– Foreign exchange earnings & Accelerating growth

– Utilisation of material and labour at lower costs

– Increased customers base & Competitive advantage

THREATS WITH CROSS BORDER MERGERS & ACQUISITIONS

– Legal issues in different countries

– Accounting challenges & Taxation aspects

–Technological differences

– Political landscape & Strategic issues

– Overpayment in the deal

– Failure to integrate & HR challenges

Legal terminology in the cross border M&A's

It involves two countries according to the applicable legal terminology:-

A.) The state where the origin of the companies that make an acquisition (the acquiring company) in other countries: – "Home Country".

B.) A country where the target company is situated refers to as the "Host Country".

Laws govern cross border mergers in India

Section 234 of the Companies Act, 2013 notified by the Ministry of Corporate Affairs provides the legal framework for cross border mergers in India. This has been brought into effect from 13th April, 2017, hence operationalising the concept of cross border merger.

The following laws govern cross border mergers in India:

- Companies Act, 2013
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
- Foreign Exchange Management (Cross Border Merger) Regulations, 2018
- Competition Act, 2002
- Insolvency and Bankruptcy Code, 2016
- Income Tax Act, 1961
- The Department of Industrial Policy and Promotion (DIPP) Transfer of Property Act, 1882
- Indian Stamp Act, 1899
- Foreign Exchange Management Act, 1999 (FEMA)