Chapter – 2
CONCEPTUAL FRAMEWORK

Chapter Contents

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2.1 INTRODUCTION

The "Corporate restructuring" is an umbrella term used to describe various methods used by companies for internal as well as external reconstruction, for acquiring corporate control. Restructuring usually involves major organizational changes such as major shift in corporate strategies to achieve desired goal. It can be internal in the form of new investments in plant and machinery, research and development of product and processes *etc.* restructuring can also take place externally through mergers and acquisitions (M&As) or by joint ventures, takeovers, strategic alliances *etc.* The need of corporate restructuring may arise when the existing business no longer remains efficient to fulfill expectations of the company viz., profitability, market share and increase in the wealth of the shareholders.

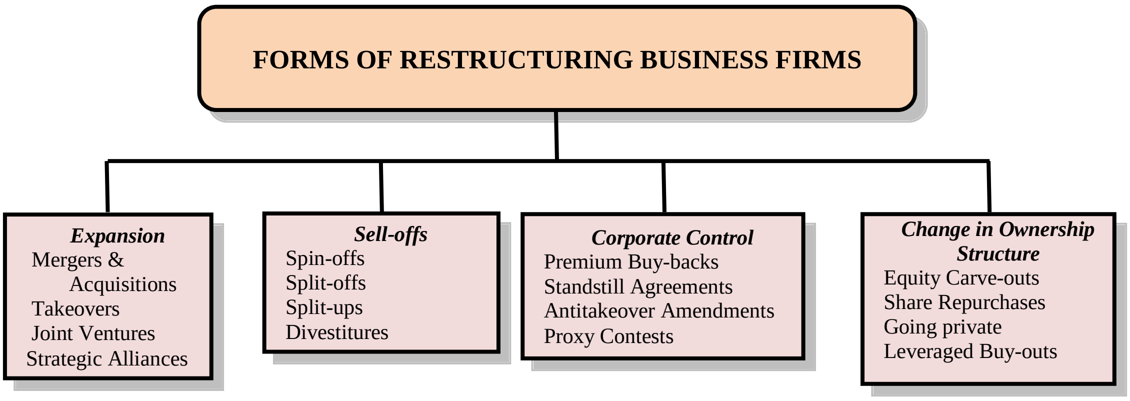
2.2 CORPORATE RESTRUCTURING: MEANING AND TYPES

2.2.1 MEANING

The aspects relating to expansion or contraction of a firm's operation or changes in its assets or financial or ownership structure are known as corporate restructuring. Corporate Restructuring is one of the most complex and fundamental phenomena that management of any organization has to deal with. It refers to the changes in ownership, business mix, asset mix and alliances with a view to enhance the shareholder value[1]. The main purpose of corporate restructuring is to enhance the shareholder value. A company should continuously evaluate its portfolio of businesses, capital mix, and ownership and assets arrangements to find opportunities for increasing the shareholder value. This threefold distinction is further elaborated as Portfolio restructuring, Financial restructuring and organizational restructuring[2]. There are many forms of corporate restructuring, mergers, acquisitions and takeovers, reorganization, divestitures, spin offs *etc.* The various form of corporate restructuring can be summarised as under:

2.2.2 FORMS OF CORPORATE RESTRUCTURING

Figure 2.1 Forms of Restructuring Business Firms



Source: Weston, Chung and Hong,(1998)[3]

1. Expansion: The forms of corporate restructuring used for increase in scale and operation of the company come under the head expansion. Like extending geographical reach, adding new products, increasing market share *etc*. There are various forms used for expansion *viz.* mergers and acquisitions, Takeovers, joint ventures, strategic alliances.

(a) Merger and Acquisition: The combining of two or more companies, generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock is called Merger. When one company purchases a majority interest in another company is called Acquisition. Merger and Acquisitions (M&A), as financial restructuring, are helpful in diversification and to regain financial returns[4]. These methods of corporate restructuring are explained in detail late in this chapter.

(b) Takeovers: A corporate action where an acquiring company makes a bid for an acquiree. If the target company is publicly traded, the acquiring company will make an offer for the outstanding shares. This can be done either by taking control through share holding or by purchase of the asset itself.

(c) Joint Ventures: Cooperation between two or more companies in which the purpose is to achieve jointly a specified business goal. Upon the attainment of the goal, the joint venture is terminated.

(d) Strategic alliances: Strategic alliance is an arrangement between two companies who have decided to share resources in a specific project, while remaining independent organizations. If we compare it with joint venture then, in strategic alliance involvement of the companies are limited to the specific project only where as in case of joint venture two companies typically pool resources in creating a separate entity.

2. Sell off: Selling a part or all firms by the ways like Spin offs, Split offs, Split ups or divestiture are termed as sell off in corporate restructuring.

(a) Spin offs: Spin-offs are divisions of companies or organizations that then become independent businesses with assets, employees, intellectual property, technology, or existing products that are taken from the parent company. A Company distributes all the shares it owns in a subsidiary, to its shareholders implying creation of two separate public companies with same proportional equity ownership. Sometimes, a division is set up as a separate company.

(b) Split offs: A split-off is a means of reorganizing an existing corporate structure in which the stock of a business division, subsidiary or newly affiliated company is transferred to the stockholders of the parent company in exchange for stock in the latter. Split-offs often occurs when the parent company wishes to draw a greater distinction between itself and the split-off business.

Split offs are typically done after the spin offs when the company is taken to public as a result of initial public offering. In case of spin off share are distributed like dividend and in case of split off, shareholders must exchange share of the parent company to receive the shares of subsidiary company.

(c) Split ups: A corporate action in which a single company splits into two or more separately run companies. Shares of the original company are exchanged for shares in the new companies, with the exact distribution of shares depending on each situation. After a split-up, the original company ceases to exist.

(d) Divestitures: The partial or full disposal of an investment or asset through sale, exchange, closure or bankruptcy. For a business, divestiture is the removal of assets from the books. Businesses divest by the selling of ownership stakes, the closure of subsidiaries, the bankruptcy of divisions, and so on.

3. Corporate Control: The forms of corporate restructuring used to increase and many a times to protect the control of the firm in the market in terms of shareholding is termed as corporate control.

(a) Premium buyback: when the company purchases or buyback its own share from the market at premium to protect itself from the possible threat of takeover is termed as premium buyback.

(b) Standstill Agreement: A standstill agreement occurs when the target corporation reaches a contractual agreement with a potential acquirer whereby, the would be acquirer agrees not to increase its holding in the target during a particular time period. Such an agreement takes place when the acquirer has established sufficient stock holdings to be able to pose a threat of takeover to target.

(c) Antitakeover Amendments: Some companies to protect their corporate control use formal methods that are put into place prior to an actual takeover attempt; these are known as antitakeover amendments.

(d) Proxy Contests: It is an unfriendly contest for the control over an organization. This usually occurs when shareholders are against some strategic decision of the firm *e.g.* takeover. The shareholders will use their voting right to bring out required change in the decision of organization.

4. Changes in ownership: The forms of corporate restructuring which result in change in ownership structure like equity carve out, privatisation, leveraged buyout and buyback of share, fall under this category.

(a) **Equity carve out:** In a carve-out, the parent company sells some or all of the shares in its subsidiary to the public through an initial public offering (IPO). Unlike a spin-off, the parent company generally receives a cash inflow through a carve-out. Since shares are sold to the public, a carve-out also establishes a net set of shareholders in the subsidiary. A carve-out often precedes the full spin-off of the subsidiary to the parent company's shareholders.

(b) **Privatisation:** The transfer of ownership of property or businesses from a government to a privately owned entity. When a publicly traded company becomes private, investors can no longer purchase a stake in that company.

(c) **Leveraged buyout:** A leveraged buyout is the acquisition of another company using a significant amount of borrowed funds to meet the cost of acquisition. This generally happens when a company is interested in buying out stake in a company but lacks financial resources. Often, the assets of the company being acquired are used as collateral for the loans in addition to the assets of the acquiring company. The purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capital.

(d) **Buy back of shares:** The buying back of outstanding shares (repurchase) by a company in order to reduce the number of shares on the market. Companies will buy back shares either to increase the value of shares still available by reducing supply or to eliminate any threats by shareholders who may be looking for a controlling stake.

2.3 MEANING AND CATEGORIES OF MERGER

2.3.1 MEANING:

A merger is a combination of two or more distinct entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but to achieve several other benefits such as, economies of scale, acquisition of latest technologies, obtaining access into sectors or markets with established players etc.

Generally, in a merger, the merging entities would cease to be in existence and would merge into a single surviving entity. The term 'merger' is not directly defined under the Companies Act, 1956 (the 'Companies Act'), the Income Tax Act, 1961 (the 'ITA') or any other Indian law. The Companies Act, 2013 gives comparatively clearer picture for merger.

Merger is defined under the definition of amalgamation explained by Section 230 of the Companies Act, 2013. It defines amalgamation as a scheme involving merger, where under the scheme the undertaking, property and liabilities of one or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing company, it is a merger by absorption, or where the undertaking, property and liabilities of two or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to a new company, whether or not a public company, it is a merger by formation of new company.

Oxford dictionary of Finance and Banking (2008)[6], defines merger as, a combination of two or more businesses on a relatively equal footing that results in the creation of new reporting entity. The shareholders of the combining entities mutually share the risk and rewards of the new entity and no one party to the merger obtains control over another. Sundarsanam & Mahate (2003)[7] defines a merger as a transaction by which two or more companies consolidated together to combine one entity or to form one entity for specific purposes such as sharing resources to achieve common objectives. But a broader definition of a merger is the complete absorption of one firm by another. The acquiring firm retains its name and its identity, and it acquires all of the assets and liabilities of the acquired firm.

2.3.2 CATEGORIES OF MERGER: Merger can be categorised as:

i. Congeneric mergers[8] are taking place within same industries and taking place at the same level of economic activity, which includes Horizontal merger and vertical merger.

ii. Conglomerate mergers are taking place between unrelated businesses.

Thus, Merger can be classified as Congeneric Merger, Horizontal Merger, Vertical Merger or Conglomerate Merger and Reverse Merger [9,10].

Congeneric Merger: These types of mergers occur when two merging firms are in the same general industry but have no mutual buyers/customer or supplier relationship. Such as a bank and a leasing company.

Horizontal Merger: A Horizontal Merger is a merger occurring between companies producing similar goods or offering similar services. Such companies that are in direct competition and share the same product lines and markets.

Vertical Merger: A Vertical Merger is a merger between two firms involved in the same business but on different levels. A merger between two companies producing different goods or services for one specific finished product where one firm acquires another firm that is in the same industry but at another stage in the production cycle. The merger permits the firm to gain more control of another level of the manufacturing or selling process within that single industry.

Conglomerate Merger: A conglomerate merger is a merger between firms that are involved in totally unrelated business activities. A conglomerate merger occurs when the companies are not competitors and do not have a buyer – seller relationship and is made up of a number of different, seemingly unconnected businesses. Each of a conglomerate's subsidiary businesses runs independently of the other business divisions, but the subsidiaries' management reports to senior management at the parent company.

Conglomerate merger may be broadly classified into following:

Product-extension merger: Conglomerate mergers which involves companies selling different but related products in the same market or sells non-competing products and use same marketing channels of production process, *e.g.* Phillip Morris-Kraft, PepsiCo- Pizza Hut, Proctor and Gamble, Clorox *etc.*

Market-extension merger: This type of conglomerate merger involves merger of companies that sell the same products in different markets/ geographic markets, *e.g.* Morrison supermarkets and Safeway, Time Warner-TCI.

Pure Conglomerate merger – In this type of merger two companies which merge have no obvious relationship of any kind, *e.g.* BankCorp of America- Hughes Electronics.

Reverse Merger[10]: Reverse merger is the way by which a public company is acquired by a private company so that the private company can bypass the lengthy and complex process of going public. The combined company may then issue securities, and hence avoid incurring the costs and scrutiny normally associated with initial public offering.

2.4 MEANING AND CATEGORIES OF ACQUISITION

2.4.1 MEANING

An acquisition is a form of corporate restructuring in which a company buys most, if not all, of the target company's ownership stakes in order to assume control of the target firm. Acquisitions are often made as part of a company's growth strategy whereby it is more beneficial to take over an existing firm's operations than to expand on its own.

Acquisition refers to the purchase of controlling interest by one company in the share capital of an existing company by (i) an agreement with majority holder of interest, (ii) purchase of new shares by private agreement, (iii) purchase of shares in open market, (vi) acquisition of share capital of a company by means of cash, issuance of share, (v) making a buyout offer to general body of shareholders[11]. International Accounting Standards (IAS 22) defines an acquisition as a transaction that “occurs when one enterprise, the acquirer, obtain control over the net assets and operations of another enterprise, the target, in exchange for the transfer of assets, incurrence of a liability or issue of equity. Also, an acquisition is the transaction by which the stocks or assets of a company, the target company, will be owned by the acquirer. The transaction may take the form of a purchase of stocks or a purchase of assets. An acquisition resembles more of an arm’s length deal, with one firm purchasing the assets or shares of another’s, and with the acquired firm’s shareholders ceasing to be owners of that firm[7]. When a company is acquired by another company, the acquiring company has two choices either to merge both the companies into one and function as a single entity and another is to operate the taken-over company as an independent entity with changes management and policies. So, Merger is a fusion of two independent entities, acquisition is buying out a company by another company and the acquired company usually loses its identity, this is usually a friendly process.

2.4.2 CATEGORIES OF ACQUISITION

There are several ways in which Acquisition transactions are classified based on their primary characteristics. In general, three major types of Acquisition transactions are distinguished: Strategic Acquisitions, Financial Acquisitions and conglomerate Acquisitions[12].

Strategic acquisitions: Most acquisitions are classified as strategic acquisitions. Strategic acquisitions are transactions in which the buying firm as well as the target firm operates in the same industry sector. In this case the buying firm believes that the combination of the two firms will operate more efficiently operating company and/or an improved market position. There are two types of Strategic Acquisitions:

- **Horizontal acquisitions:** Horizontal acquisitions are deals in which both firms operate in the same industry sector, *i.e.*, they produce similar products or they target the same customers.

- **Vertical acquisitions:** Transactions in which a certain firm acquires another firm in the same value chain are referred to as vertical acquisitions. The objective behind such acquisitions is to integrate companies at different stages within a product value chain.

Financial acquisitions: Financial acquisitions are transactions where incentive and efficiency improvements are the primary motives. These acquisitions are often called leveraged buyouts (LBOs) and are financed with high levels of debt.

Conglomerate acquisitions: Conglomerate acquisitions are acquisition deals not classified as strategic or financial acquisitions. These transactions involve the combination of unrelated types of business and are often motivated by diversification benefits and risk reduction.

2.5 HISTORY OF MERGER WAVES

M&A as a strategic initiative has grown in prominence ever since the 20th century. More so hindsight shows that certain time periods witness surging activity a development termed 'merger waves'. These waves are found to reach their peak during times of economic prosperity and recede when such fortunate times disappear[13].

Table 2.1 summarises the merger waves.

Table 2.1 Merger Waves

Waves	Period	Details
First wave	1897-1904	Horizontal Mergers
Second Wave	1916-1929	Vertical Mergers
Third Wave	1965-1969	Diversified Conglomerate Mergers
Fourth Wave	1984-1989	Hostile Takeovers , Congeneric Mergers
Fifth Wave	1992-2000	Mega Mergers, Cross border Mergers
Sixth Wave	2003-2008	Private Equity Deals, Shareholder Activism

Source: kpmg, 2000[14]

***First Wave – 1897 to 1904*:** This merger wave was charactrised by horizontal mergers and started around the time of industrial revolution of 1890s. It resulted into monopolies and high concentration in many industries like oil, mining, railroad and other giants of the basic manufacturing and transportation industries. The merger wave subsided during 1904, when U.S. Supreme Court enforced antitrust laws to horizontal mergers. The First World War was the cause of end of the first wave.

Second Wave – 1916 to 1929: Antitrust law resulted into breaking up of large monopolies and route of inorganic growth has shifted from horizontal mergers to vertical mergers. This was focused on achieving economies of scale rather than increasing market power like first wave and gave rise to oligopolistic market .The major automobile manufacturers emerged in this period e.g. Ford. The 1929 stock market crash and the great depression ended this wave.

In theory economists consider six merger waves, where the first two were primarily a phenomenon related to US activity, however recent evidence show that activity in the US and Europe have become increasingly and positively correlated, hence the waves of the late 60's and onwards also occurred on European soil[15].

***Third Wave – 1965 to 1969*:** Because of great depression and Second World War the business activity was not growing. Hence it took almost three decades to witness the next merger wave. This wave was not only in U.S. but also in U.K. This was the period in which the conglomerate concept took hold, the bidder firm was smaller than target firm and mergers were financed from equities. Major conglomerates like IT&T, Teledyne and Litton were created. The conglomerate stocks crashed in 1969-70 due to oil crisis and the diversified companies never achieved the benefits thought to be derived from diversification.

***Fourth Wave – 1984 to 1989*:** Generally referred to as the merger wave, or takeover wave, which started after the recovery of the economies from recession and oil crisis. This wave emerged with the reversal of the earlier inefficient unrelated diversifications that took place in the earlier wave[16]. The first major hostile bid was made by Morgan Stanley on behalf of Inco seeking to take over ESB. This successful hostile bid opened the door for the major investment banks to make hostile takeover bids on behalf of raiders. In addition to hostile bids, this period was noted for junk bond financing and steadily increasing volume and size of LBOs. In Europe in the latter half of the 1980s companies sought to prepare for the common market through cross-border horizontal mergers. It ended in 1989-90 with the collapse of the junk bond market, along with the collapse of the savings and loan banks and the serious loan portfolio and capital problems of the commercial banks.

***Fifth Wave – 1992 to 2000*:** This was the era of the mega-deal and cross border mergers. This wave experienced large volume and value of deals. This wave was of global nature, means it did not raise from U.S. or U.K. but from Asia and Africa, which resulted in huge number of cross border deals. It ended with the bursting of the millennium bubble and the great scandals, like Enron, which gave rise to the revolution in corporate governance that is continuing today.

Sixth Wave – 2003 to 2008: The sixth wave has similar features as fifth wave. Mega deals and cross border transactions increased significantly. The key factors responsible for the wave were shareholder activism, significant rise in prices of major commodities, low cost sources of fund, financing and hedge funds and growth of private equity. The sixth wave ended after global economic crisis which begin with subprime crisis.

It can be observed that each wave has started with different set of motives and triggers and ended with the events like regulatory changes, increase competitions, change in economic conditions, technical innovations, financial changes *etc.*

2.6 MOTIVES OF MERGER AND ACQUISITION

The underlying forces behind merger decisions are often complex and multifaceted. Companies undergo merger or acquisition for many reasons. Some may wish to improve their market position, to globalize, for technical innovation, or may wish to take on a challenging role and take over a struggling company which has a good market position, but is struggling financially or for the revival of sick unit. The empirical evidence suggests that no single objective adequately explains the motive behind all the M&As[17]. Trautwein (1990)[18] suggested six categories of motives behind M&As, which have also be described as theories of M&A.

Figure 2.2 Merger Motives

<table>
<tr><td rowspan="4">Merger as rational choice</td><td rowspan="3">Merger benefits to the bidder's shareholders</td><td>Net gains through synergies</td><td>Efficiency Theory</td></tr>
<tr><td>Wealth transfer from customers</td><td>Monopoly Theory</td></tr>
<tr><td>Net gains through private information</td><td>Valuation Theory</td></tr>
<tr><td colspan="2">Merger benefits to managers</td><td>Empire building theory</td></tr>
<tr><td colspan="3">Merger as process outcome</td><td>Process Theory</td></tr>
<tr><td colspan="3">Merger as macroeconomic phenomenon</td><td>Disturbance theory</td></tr>
</table>

Source: Trautwein, 1990[18]

Efficiency Theory: According to efficiency theory, M&As are motivated by the possible synergies that can result in improvement in efficiency. Synergy is simply when the value of the combined firm involved in M&A's process is more than the sum of two individual firms. The concept of synergy is used to refer economies of scale at firm level. There are three types of synergies - operational, financial and managerial. *Operational synergy* may arise due to reduction in costs, which is the result of economies of scale and economies of scope. Economies of scale will result from increase in size and scale of company after M&A and economies of scope will arise if combined entity offer unique product and services. *Financial synergy* will arise in case of conglomerate M&As, when company invests in diversified business its systematic risk will reduce. Due to increase in size and stability of cash flows, company have access to cheaper source of fund which will reduce it's cost of capital. *Managerial synergies* may arise if the managers of acquirer entity possess superior managerial abilities that may improve the performance of the target firm. This synergy is not relevant in case of conglomerate M&As as it involves M&A in diversified businesses and it may not be possible to develop managerial capacity in short span. It is more applicable in case of horizontal and vertical M&As where M&As are in related areas.

Monopoly Theory: Companies acquire other companies to achieve market dominance. Monopoly theory suggests that mergers are driven by desire to gain a foothold in a competitor's main market[19]. Some companies realize in order to command more of the market shares in their particular industry they must purchase a competitor or a company with similar products. Companies also merge or acquire another company when they may have a good market position but have fallen on hard times financially. Under this scenario, the troubled company can be acquired at a very low price and the acquiring company may along with it acquire its lion share of the market. This scenario acts as a motive for M&A because it is like a "win-win" situation for both companies.

Valuation Theory: Valuation theory says that managers of acquirer company know more about the target firm's potential for financial performance than other companies in the stock market. Managers of acquirer firm have private information about mispricing of target and they take advantage of this through M&As. This theory is criticized on the ground that due to this understanding of manager of acquirer firm, they often overvalue stock of target firm which at a later stage may become reason of failure of M&As.

Empire Building Theory: According to this theory, M&As are driven by manager's desire to maximize their utility instead of shareholders value. Managers have more inside information than shareholders. This information asymmetry may cause conflict (which is popularly known as Agency Theory) between them if managers use this information for their own benefit. The reason behind this conflict is shareholder need maximization of their wealth by maximizing firm's value and manager wants maximization of their remuneration or satisfaction of their ego. Empire building is one of the motives which are the reason for M&A. In the process of empire building managers might unintentionally and randomly make errors in M&A process which leads to excessive premiums paid for the target companies. On the other hand managers who are rational may make valuation mistakes and deliberately overpay for target companies to make M&A deal happen due to personal motive, at the expense of the shareholders.

Process Theory: According to process theory M&A activity is result of strategic decision making where the decisions are not governed by comprehensive rational choice. M&A occurs because of decisions makers' limitation in acquiring and processing information or may result from power politics. Hubris or managerial pride also play role in M&As for their own personal reasons rather than the economic gains of the company they are managing. This is known as hubris hypothesis, which was first proposed by Roll (1986)[20] and it implies that managers commit errors of over-optimism in evaluating mergers at the cost of the company[20].

Disturbance Theory: It has been observed in the merger waves that these waves were result of some economic events or disturbances. Like first merger wave stated with industrial revolution in 1890s, the second wave was result of breaking of antitrust laws and other are result of takeover code, liberalizations policies, oil crisis *etc.* During this era business sentiments are affected due to change in political and mainly economic conditions. This is known as disturbance theory, given by (Gort 1969)[21]. Studies reveal that returns on successful deals during high merger activity era are slightly higher than those of low merger activity era[22].

These theories summarize the major motive behind M&As. They also give clarification about economic and non economic benefits chased during the process of M&As.

Apart from these, there are other reasons also, which drives M&As. They are as follows:

Tax Shields: A company, which has incurred losses in the past, can carry forward such losses and offset them against future taxable profits and reduce tax liabilities. Such a company when merged with a company with large taxable profits would help to absorb the tax liability of latter. A similar advantage exists when a company is modernizing or investing heavily in plant and machinery, which entitles it to substantial investment incentives, but has not much taxable profits to offset them with. Acquiring or merging such a company with a highly profitable company would help make full use of the investment incentives for the latter.

Deregulation: It is one of the important factors for the increase in the number of mergers and acquisitions in a specific industry. Opportunities for companies are created as deals which were previously prevented are made possible through deregulation.
Inorganic growth through M&A is now very well accepted phenomena, these motives help to understand main reasons behind initiation of M&A process.

2.7 CAUTIONS WHILE PLANNING FOR MERGER AND ACQUISITION

There is no unanimous opinion about the outcome of M&A but then also M&A occurs day in and day out across the globe. Many researchers have carried out their study to find the reasons behind failure of M&As so that the company planning for M&A can take due care of those factors[23,24,25]. These reasons are summarized below.

1. **Poor Strategic fit:** M&A is a strategic decision. Companies undergo M&A not only for financial reasons but for other reasons also. If the strategy is not clearly understood than a firm may land up acquiring a target which may have

a superficial strategic fit. This will hinder the further planning of the acquirer firm and lead to failure of M&A.

2. **Lack of Pre and Post integration planning:** M&A is not a day decision. It requires planning well in advance and also needs due attention after the event. It has observed that proper execution of M&A process has not been exercised and the main motive of M&A is not properly explained and preserved by the companies. This could lead to various problems in post M&A period especially with reference to personnel and departments of target company. Even the power struggles are also noticed between high authorities of both the companies in post M&A integration process. This will lead to deviation in the results of M&A from what was planned to be achieved.

3. **Clarity of motive:** As explained in previous section, M&A happens due to variety of motives. It could be growth, expansion of market, revival of sick unit, tax benefits *etc.* when the company plans for M&A, the motive behind it should be very clear. Then only it is possible for the company to achieve ultimate goal. The problem here is often there are various motives behind M&A, so it is difficult for the company to concentrate on and communicate its motive clearly.

4. **External Environment:** The external environment in the economy surrounding the deal is very complex and has to be examined carefully before acquiring a company. This is very important in case of cross border deals. Different countries have their own rules and which may change from time to time. Sometimes the bidder forgets to examine these factors and is not prepared to handle the regulations that may be involved, this leads to a failure.

5. **Poor cultural fit:** The cultural difference between the companies is the major reason for resistance to integration, especially the management integration. The miscommunication within the workforce also creates uncertainty. This is generally seen in cross border M&A. Cultural differences reflect the way decisions are made between the companies. The acquirers often take the communication process lightly and do not convey their plans and expectations and are not able to allay the anxieties of the target personnel.

Also the slack attitude and lacked self motivation of the target company's management plays an important role in the failure of the merger.

6. **Lack of accountability: '**Responsibility of all is responsibility of none' M&A is always a management's decision, a kind of joint decision. So managers are always ready to take credit if everything went smoothly but nobody is ready to take responsibility of ultimate outcome of M&A, if it is not up to the mark. Also the managers may have different expectation from the deal on personal ground like compensation, hubris *etc.*

7. **Lack of previous M&A experience:** This affects at both the stages in valuation of target and also in post integration process. If the company is not having previous M&A experience then it may end up paying excessive premium to the target firm. Also they may not give proper attention to post integration aspects like cultural differences, power struggles, clarity of motive *etc.* This may lead to failure of M&A.

8. **Over optimism about deal outcomes:** Sometimes being overoptimistic and overconfident about the market conditions leads to failure of the M&A deals. Management always tries to present the greener side of the deal in order to win the votes of the shareholders to accept an over price deal. After that if the firm is not able to achieve desired motive than it will create dissatisfaction among the shareholders and may lead to failure of M&A.

2.8 PROCESS OF MERGER AND ACQUISITION

It is found in literature that the M&A process are described slightly differently by different authors. Process of M&A can be described based on two different aspects: (i) Strategic Process, and (ii) Legal Process

According to Picot (2002)[26], a typical Strategic M&A process goes through three phases: planning, implementation and integration. In the planning phase, the overall plan for the transaction is developed "in the most interdisciplinary and comprehensive manner possible"[27]**.** Planning covers the operational, managerial and legal techniques and optimization with special regards to the two following phases. The implementation phase covers a range of activities starting from the issuance of confidentiality or non-disclosure agreements, letter of intent and ending with the conclusion of the M&A contract and deal closure. The last phase is concerned with post-deal integration. Of a similar manner is the Watson Wyatt Deal Flow Model introduced by Galpin and Herndon, (2000)[27]. However, their model breaks down the process into five smaller stages namely Formulate, Locate, Investigate, Negotiate and Integrate. The most significant milestone is when the two transacting firms sign the agreement, finishing the deal and entering the integration stage.

Figure: 2.3 Process of Merger and Acquisition

Formulate	Locate	Investigate	Negotiate	Integrate
* Set business strategy * Set growth strategy * Define acquisition criteria *Begin strategy implementation	*Identify target markets and companies *Select Target *Issue letter of intent *Offer letter of confidentiality	*Conduct due-diligence analysis *Summarise findings *Set preliminary integration plan *Decide negotiation parameters	*Set deal terms (Legal, Structural, Financial) *Secure key talent and integration teams *Close deal	*Finalize and execute integration plan * Organisation * Process *People *System
Strategy and Integration Process Development	Pre deal (assessing, planning, forecasting value)		Deal (agreeing on value)	Post deal (realizing value)

Source: Galpin and Herndon (2000)[27]

The first three stages then belong to the pre-deal phase while 'Negotiate' represents the deal phase which ends when the above milestone is achieved, and the post-deal phase only contains the last stage termed 'Integrate'. The Watson Wyatt model includes in the first stage 'Formulate' for the setting of business strategy as well as growth strategy.

The above model presents the stages in a linear order; however in reality, as Galpin and Herndon (2000) [27] suggest, more often than not the firm starts a stage when the previous one has not been completed. And the five stages are interdependent and "concurrently engineered to provide the right input and the right decision at the right time" M&A process defined here is from strategic point of view, from legal perspective steps in M&A process are as follows:

(1) Examination of object clauses: The Memorandum of Association of both the companies should be examined to check the power to amalgamate is available. Further, the object clause of the merging company should permit it to carry on the business of the merged company. If such clauses do not exist, necessary approvals of the share holders, board of directors, and company law board are required.

(2) Intimation to stock exchanges: The stock exchanges where merging and merged companies are listed should be informed about the merger proposal. From time to time, copies of all notices, resolutions, and orders should be mailed to the concerned stock exchanges.

(3) Approval of the draft merger proposal by the respective boards: The draft merger proposal should be approved by the respective BOD's. The board of each company should pass a resolution authorizing its directors/executives to pursue the matter further.

(4) Application to high courts: Once the drafts of merger proposal is approved by the respective boards, each company should make an application to the high court of the state where its registered office is situated so that it can convene the meetings of share holders and creditors for passing the merger proposal.

(5) Dispatch of notice to share holders and creditors: In order to convene the meetings of share holders and creditors, a notice and an explanatory statement of the meeting, as approved by the high court, should be dispatched by each company to its shareholders and creditors so that they get 21 days advance intimation. The notice of the meetings should also be published in two news papers.

(6) Holding of meetings of share holders and creditors: A meeting of share holders should be held by each company for passing the scheme of mergers at least 75% of shareholders who vote either in person or by proxy must approve the scheme of merger. Same applies to creditors also.

(7) Petition to High Court for confirmation and passing of HC orders: Once the mergers scheme is passed by the share holders and creditors, the companies involved in the merger should present a petition to the HC for confirming the scheme of merger. A notice about the same has to be published in 2 newspapers.

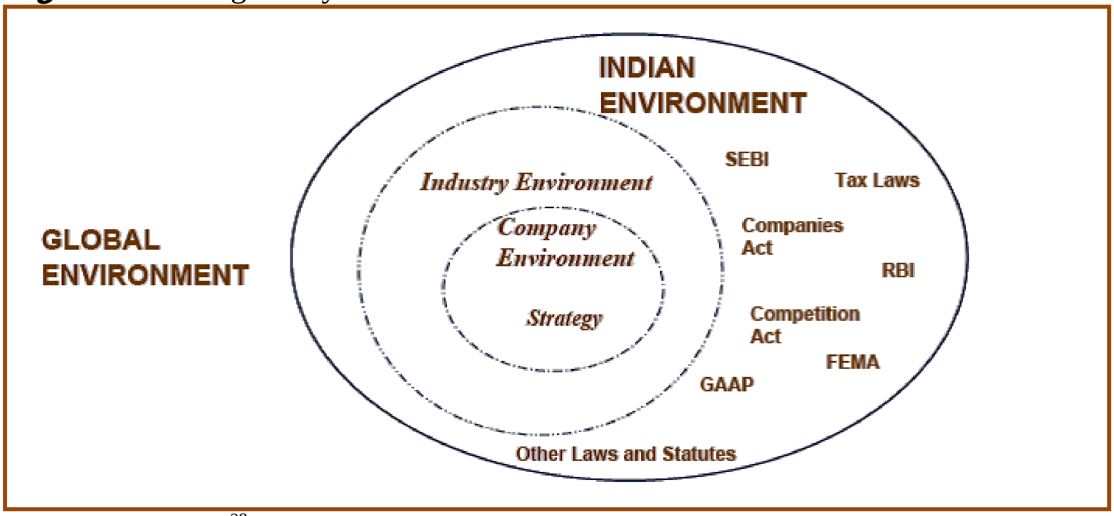
(8) Filing the order with the registrar: Certified true copies of the high court order must be filed with the registrar of companies within the time limit specified by the court.

(9) Transfer of assets and liabilities: After the final orders have been passed by both the HC's, all the assets and liabilities of the merged company will have to be transferred to the merging company.

2.9 REGULATORY FRAMEWORK OF MERGER AND ACQUISITION IN INDIA

M&A is a regulated activity with various legal provisions applicable to any M&A deal. The legal provisions applicable depends on various factors such as whether the M&A is in a private space or is a public M&A, whether any non-resident investor is involved in the M&A or not. Plethora of regulations including foreign exchange regulations, securities regulations, anti-trust laws, taxation, general corporate commercial laws apply to any M&A activity. Most of the legal systems have been reviewed and are being reformulated in accordance with the emerging corporate scenario in India.

Figure 2.4 Regulatory Framework in India



Source: FICCI 2009[28]

Figure 2.4 shows the various environments affecting the company's decision regarding M&A. The strategy of company regarding M&A is first affected by company's own environment and then the environment of industry to which it belongs. There are various regulatory aspects, like Companies Act, SEBI, Tax Laws, RBI, Competition Act, GAAP, FEMA *etc.*, which are part of Indian environment and the company needs to comply with them while taking strategic decision of M&A. Some of such regulatory aspects are discussed below:

- **The Companies Act, 2013**[29]**:** Company law in India was undergoing a complete overhaul and a new law was finally passed in 2013. 283 out of 470 sections of the Companies Act, 2013 have been brought into force by 1st April 2014. The provisions relating to mergers and acquisition covered in Sections 230 to 240 of Companies Act 2013 are yet to be notified and will come in force after establishment of NCLT *i.e.* National Company Law Tribunal (October 2016). Until then, this high court driven process of M&A will continue to be governed by Section 391-396A of the Companies Act, 1956. Chapter XV of the 2013 Act deals with *"Compromises, Arrangements and Amalgamations."* Few key changes are as follows:

  1. Fast-track merger ("short form" mergers): Under the 1956 Act, all mergers and amalgamations require court approval. The 2013 Act requires that mergers and amalgamations between two or more small companies or between holding companies and its wholly-owned subsidiary do not require court approval. However, notice has to be issued to ROC and official liquidator and objections / suggestions have to be placed before the members.

  2. Cross-border mergers: The 1956 Act does not contain provisions for merger of Indian company with a foreign company. The 2013 Act states that merger between Indian companies and companies in notified foreign jurisdiction shall also be governed by the same provisions of the 2013 Act. Prior approval of Reserve Bank of India would be required and the consideration for the merger can be in the form of cash and or of depository receipts or both.

  3. Mergers of listed companies with unlisted ones: The 1956 Act does not contain any specific provision governing the merger of a listed company with an unlisted one. The 2013 Act requires that in case of merger between a listed transferor company and an unlisted transferee company, Transferee Company would continue to be unlisted until it becomes listed.

4. Minority buyout: The 2013 Act has introduced an exit mechanism for minority shareholders also, with the intent of reducing litigation with minority shareholders. The Act grants access to the acquirer or person acting in concert or a person or a group of persons becoming registered shareholders of 90% or more of the issued equity share capital of the target company (listed or unlisted) by virtue of amalgamation, share exchange, conversion, securities or for any other reason. Such an acquirer, person or a group of persons will notify minority shareholders about their intention of buying the remaining equity shares.

5. Compliance with Accounting Standards: The 2013 Act has introduced a new requirement, that no scheme of compromise or arrangement, whether for listed company or unlisted company shall be sanctioned unless the company's auditor has given a certificate that the accounting treatment of the proposed scheme is in conformity with the prescribed accounting standards.

- **The Securities and Exchange Board of India Act, 1992[30]:** Section 12(A) of the Securities and Exchange Board of India Act, 1992 deals with prohibition of manipulative and descriptive devices, insider trading and substantial acquisition of securities or control. Regarding the acquisition of fifteen percent or more of the shares or voting rights of any company, the act states that, no acquirer shall acquire shares or voting rights which (taken together with shares or voting rights, if any, held by him or by persons acting in concert with him) entitle such acquirer to exercise fifteen percent or more of the voting rights in a company, unless such acquirer makes a public announcement to acquire shares of such company in accordance with the Regulations. Regarding the acquisition of control of any company, the act clarifies that, irrespective of whether or not there has been any acquisition of shares or voting rights in a company, no acquirer shall acquire control over the target company, unless such person makes a public announcement to acquire shares and acquires such shares in accordance with the Regulations.

- **The SEBI (Substantial Acquisition of Shares & Takeover Regulations),1994[31]:** 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. 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, 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.

- **The Income Tax Act, 1961[32]:** 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.

- **The Competition Act, 2002[33]:** Following provisions of the Competition Act, 2002 deals with mergers of the company:-

  (1) 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.

  (2) Section 5 of the Competition Act, 2002 deals with “Combinations” which defines combination by reference to assets and turnover

  (a) Exclusively in India

  The threshold limit for the parties to the acquisition are the assets of the value of more than Rs. 1000 crores or turnover more than Rs. 3000 crores. For the group the combined limit of assets is Rs. 4000 crores or turnover more than Rs. 12,000 crores

  (b) In India and outside India.

  The threshold limit for the parties to the acquisition are the assets of the value of more than US $ 500 million, including at least Rs. 500 crores in India or turnover more than US $ 1500 million, including at least Rs. 1500 crore in India. For the group the combined limit of asset is 2 billion US$, including at least Rs.500 crores in India or turnover more than 6 billion US$, including at least Rs. 1500 crores in India.

The transactions like intra-group combinations, mergers, demergers, reorganizations and other similar transactions do not have any competitive impact on the market for assessment under the Competition Act. Therefore, all these types of transactions should be specifically exempted from the notification procedure and appropriate clauses should be incorporated in sub-regulation 5(2) of the Regulations.

- **Mandatory High Court Approval:** Any scheme of merger has to be sanctioned by the courts of the country. The Companies 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 Foreign Exchange Management Act 1999[34]:** 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".

2.10 SUMMARY AND CONCLUSIONS

Interdependency and need for growth have encouraged Indian business entities to opt for comparatively easy tool for development *i.e.* corporate restructuring. This chapter presents conceptual framework for corporate restructuring with special reference to M&A. The umbrella of corporate restructuring, under which M&A falls, is explained first. Then meaning, definition and categories of merger and acquisition are given. History of global M&A is presented in the form of merger wave, followed by motives and cautions while planning for M&A. At the end Strategic and legal procedure of M&A and regulatory framework governing M&A in India is summarised.

Whenever planning for organizational change, the corporate should first clearly define its motive and accordingly select the different methods or ways available for internal as well as external restructuring, under the umbrella of corporate restructuring. If the organization does not have prior experience of it, then it should study the process carefully and also give due attention to reasons of failure to avoid them. At last the manager of the firm undergoing corporate restructuring should possess sufficient knowledge of regulatory framework governing restructuring.

After reviewing Conceptual Framework of M&A, the following chapter presents "Review of Literature" to examine researches carried out in India and Abroad and also to identify research gap.

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