Corporate Restructuring

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Syllabus

Unit 1: Corporate Restructuring – An Overview (12 hours)
Concept and importance of corporate restructuring, various forms of restructuring: joint ventures (types), Strategic alliance (types), Merger(types), Acquisition(types), Consolidation, Divestiture, Demerger (Spin-off, Split-up, Split-off), Equity carve-out, Management buyout, Leveraged buyout, Buyback of securities, ESOP.

Unit 2: Merger & Acquisition (12 hours)
Motives behind M&A, theories of M&A, process of M&A. Fast track merger. Cross border M&A – concept, benefits & difficulties. Due diligence process. Methods of payment and financing options in M&A. Takeover defense tactics. Reasons for failure of M&A.

Unit 3: Deal Valuation and Evaluation (15 hours)
Methods of valuation; cash flow approaches, economic value added (EVA) (with numerical), sensitivity analysis (with numerical), Valuation for slump sale, valuation of synergy (with numerical), cost-benefit analysis and swap ratio determination (with numerical).

Unit 4: Legal and Regulatory Framework of M&A (6 hours)
Provisions of Companies Act 2013, SEBI Takeover Code 2011, Provisions of Competition Act 2002.

Books and References

Essential Readings:

1. Weston, F., Chung, K. S., & Siu, J. A. (n.d.). *Takeovers, Restructuring, and Corporate Governance*. Pearson Education.
2. Gupta, M. (2010). *Contemporary Issues in Mergers and Acquisitions*. Himalaya Publishing.
3. Sundarsanam (2006). *Creating Value from Mergers and Acquisitions* (1st ed.). Pearson Education.

Additional Readings:

1. Ramanujan, S. (1999). Mergers: The New Dimensions for Corporate Restructuring. McGraw Hill.
2. Narayankar, R. (2013). Merger and Acquisitions: Corporate Restructuring, Strategy, and Practices (2nd ed.). International Book House Pvt. Ltd.

Unit 1: Corporate Restructuring – An Overview

- Concept and Importance of corporate restructuring,
- Various forms of restructuring:
  - Joint ventures (types),
  - Strategic alliance (types),
  - Merger(types),
  - Acquisition(types),
  - Consolidation,
  - Divestiture,
  - Demerger (Spin-off, Split-up, Split-off),
  - Equity carve-out,
  - Management buyout,
  - Leveraged buyout,
  - Buyback of securities,
  - ESOP.

Corporate Restructuring

Restructuring as per Oxford dictionary means

“to give a new structure to, rebuild or rearrange".

New Structure / Rebuild / Rearrange

Business Strategy

Corporate Restructuring …..an Example

Perfect match matching

ABC Limited with surplus funds but no viable projects.

XYZ Limited with viable projects but no money to fund the cost of the project.

Corporate Restructuring

PERFECT match matching

Does it exist?

Corporate Restructuring

Corporate restructuring is an inorganic growth strategy.

Types of Growth

- Organic:
  - Growth through Internal strategies
  - No changes in corporate entity of the company
  - Eg. Capital restructuring

- Inorganic:
  - Growth through external strategies
  - May create a change in corporate entity of the company
  - Eg. M&A, Takeover, Acquisition etc.

Corporate Restructuring

- Any change in the business capacity or portfolio that is carried out by an inorganic route or
- Any change in the capital structure of a company that is not in the ordinary course of its business or
- Any change in the ownership of a company or control over its management, or
- A combination of any two or
- All of the above

Changes not defined as Corporate Restructuring

- Initial creation of a corporate structure
- Change in the internal command structure or hierarchy
- Change in the business processes
- Downsizing
- Outsourcing
- Enterprise resource planning
- Total quality management
- Licensing

Corporate Restructuring Objectives

- To obtain core competency
- To achieve economies of scale
- Risk reduction
- To obtain operational synergy
- To obtain efficient allocation of managerial capabilities
- To better deploy surplus cash from one business to finance profitable growth in another
- To eliminate disadvantage and to combine advantages
- To enhance competitive advantages
- Orderly redirection of the firm's activities

Types of Restructuring

- Financial
- Market
- Organisational
- Technological

Types of Restructuring - Financial Restructuring

- Financial restructuring deals with restructuring of capital base and raising finance for new projects. Financial restructuring helps a firm to revive from the situation of financial distress without going into liquidation.
- Financial restructuring is done for various business reasons:
  - Poor financial performance
  - External competition
  - Erosion or loss of market share
  - Emerging market opportunities
- It involves:
  - Equity Restructuring like buy-back, Alteration/Reduction of capital and
  - Debt Restructuring like restructuring of the secured long-term borrowing, long-term unsecured borrowings, Short term borrowing.

Types of Restructuring – Market Restructuring

- Market Restructuring involves decisions with respect to the product market segments where the company plans to operate on its core competencies.

Types of Restructuring – Technological Restructuring

- Technological restructuring occurs when a new technology is developed that changes the way an industry operates.
- This type of restructuring usually affects employees, and tends to lead to new training initiatives, along with some layoffs as the company improves efficiency.
- This type of restructuring also involves alliances with third parties that have technical knowledge or resources.

Types of Restructuring – Organisational Restructuring

- Organizational Restructuring involves establishing internal structures and procedures for improving the capability of the personnel in the organization to respond to changes. These changes need to have the cooperation of all levels of employees. Some companies shift organizational structure to expand and create new departments to serve growing markets. Other companies reorganize corporate structure to downsize or eliminate departments to conserve overheads.

Types of Corporate Restructuring

Corporate Restructuring

- Merger
- Consolidation
- Amalgamation
- Takeover
- Slump Sale
- Demerger
- Reverse Merger
- Divestiture
- Buyback
- Franchise
- Strategic Alliance
- Joint Venture
- ESOP
- Management Buyout
- Leverage Buyout

Merger or Amalgamation

The term ‘merger or Amalgamation’ is not defined under the Companies Act, 2013.

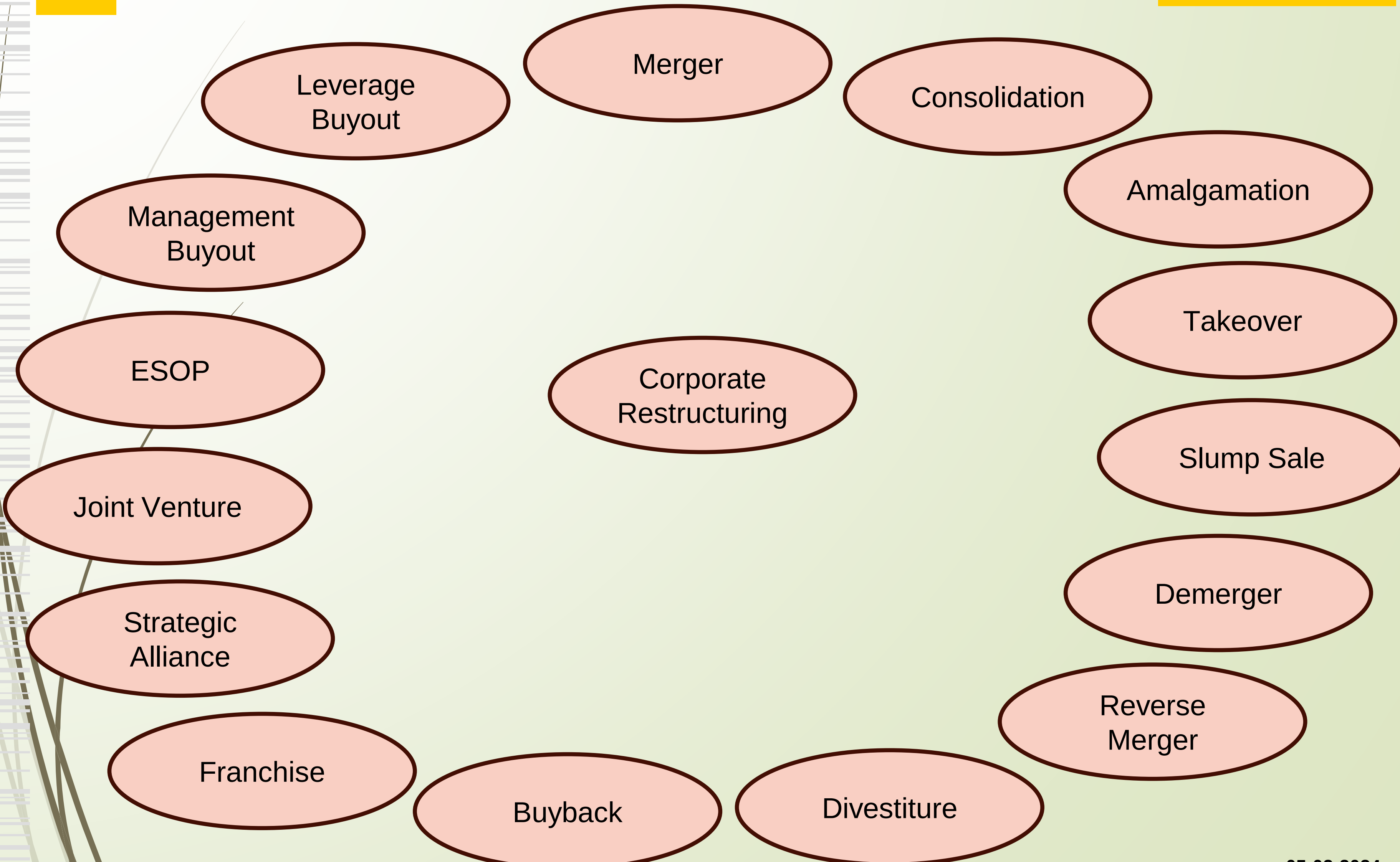
Merger

Merger is the combination of two or more companies which can be merged together either by way of amalgamation or absorption or by formation of a new company. The combining of two or more companies, is generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock.

- Merging company
- Merged company

- Eg. Vodafone Idea

Types of Corporate Restructuring



Consolidation

Hindustan Computers Ltd.,
Hindustan Instruments Ltd.,
Indian Software Company Ltd. and
Indian Reprographics Ltd.

Hindustan Computers Limited

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Amalgamation

- Section 2(1B) of the Income Tax Act defines the term amalgamation as "the merger of one or more companies with another company or the merger of two or more companies to form a new company."

- Amalgamating company
- Amalgamated company
- Transferor company
- Transferee company

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Takeover / Acquisition

It is also known as acquisition.

Takeover occurs when an acquirer takes over the control of the target company. Normally this type of acquisition is undertaken to achieve market supremacy. It may be friendly or hostile takeover.

- Target company
- Acquiring company

Takeover / Acquisition Contd.

- Acquire substantial percentage of voting capital
- Acquire voting rights through proxy voting
- Acquire control over holding company
- Acquire management control through formal or informal understanding or agreement with person controlling the target company

- Eg.: Tata Motors acquired Jaguar Land Rover
- Eg.: Flipkart acquired eBay India

Holding and Subsidiary company

- **A, B, C, D**

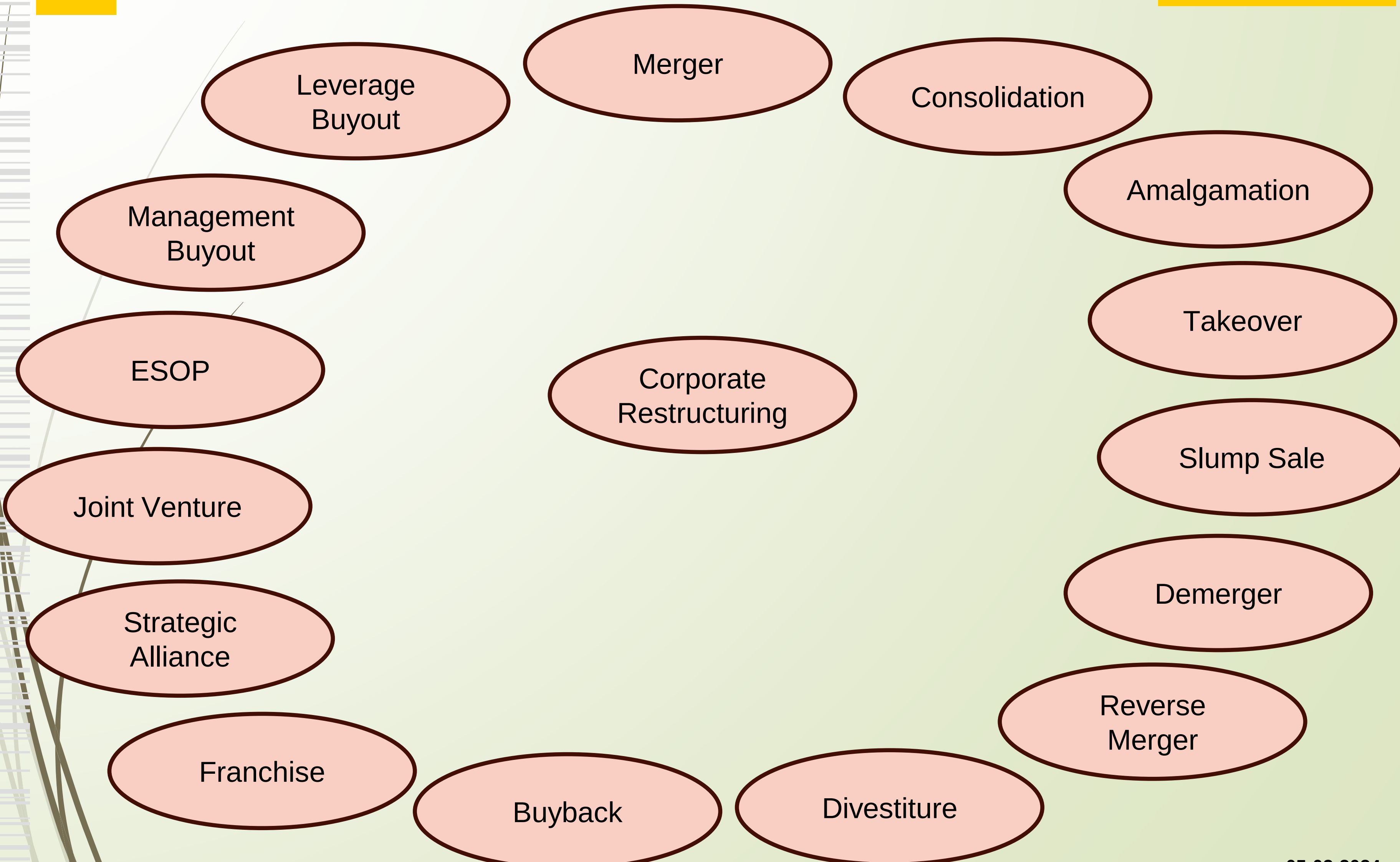
- **A** is holding co of Bco - shares
- A will become holding of B, C D

- B is subsidiary co. of A
- B is holding of C co

- **C** is subsidiary co. of B
- C is holding of D co

- D is subsidiary co. of C

Types of Corporate Restructuring

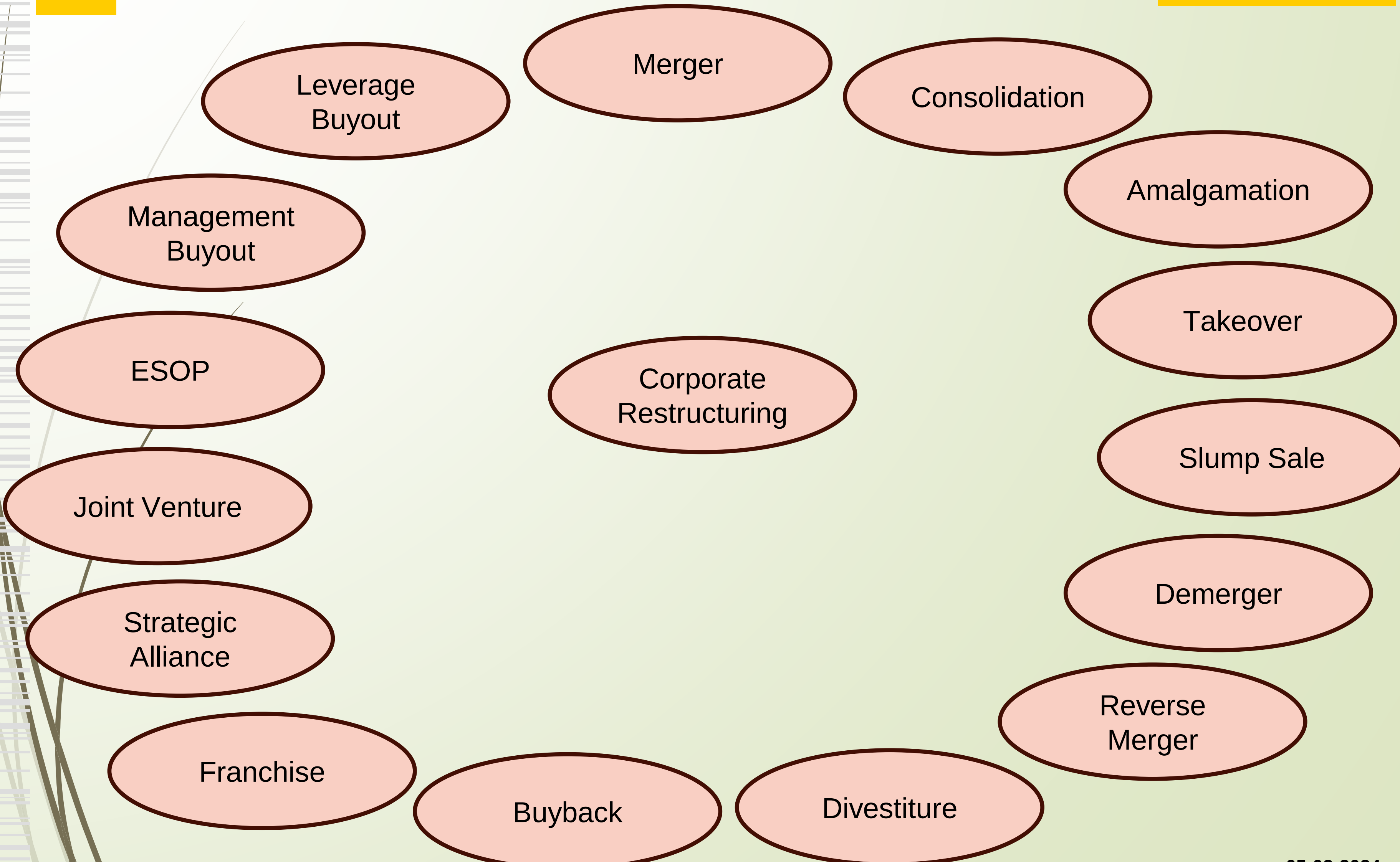


Slump Sale

Transfer of one or more undertaking as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. If a company sells or disposes of the whole or substantially the whole of its undertaking for a predetermined lump sum consideration, then it results in a slump sale.

Eg.: Slump sale of formulations business by Piramal Health Care Ltd. to Abbott Healthcare Private Limited.

Types of Corporate Restructuring



Demerger

Entity's business operations are segregated into one or more components. A demerger is often done to help each of the segments operate more smoothly, as they can focus on a more specific task after demerger.

- Demerged company
- Resulting company

- Eg.: Larsen and Toubro Ltd. Cement division to UltraTech CemCo Ltd. (UCL).

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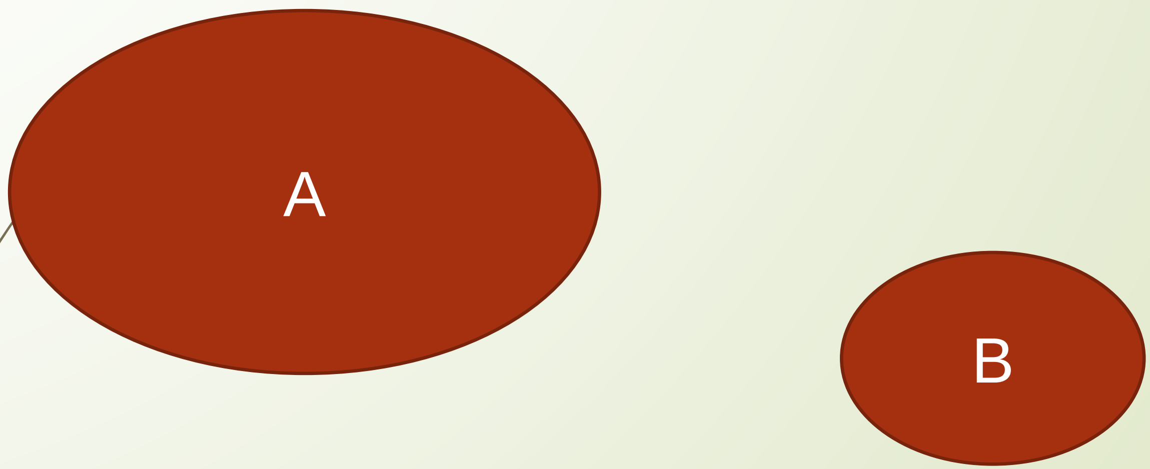
Reverse Merger

- A is company
- B is a company



Reverse Merger

- A weaker or smaller company acquires a bigger company
- Private companies acquiring public company
- A parent company merges into its subsidiary
- A loss-making company acquires a profit-making company

Examples:

- Merging of ICICI Ltd. with its arm ICICI Bank – size
- Godrej Soaps with Godrej Innovative Chemicals. – Loss
- Indiabulls Financial Services Ltd. into its wholly-owned subsidiary, Indiabulls Housing Finance Ltd.

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Disinvestment

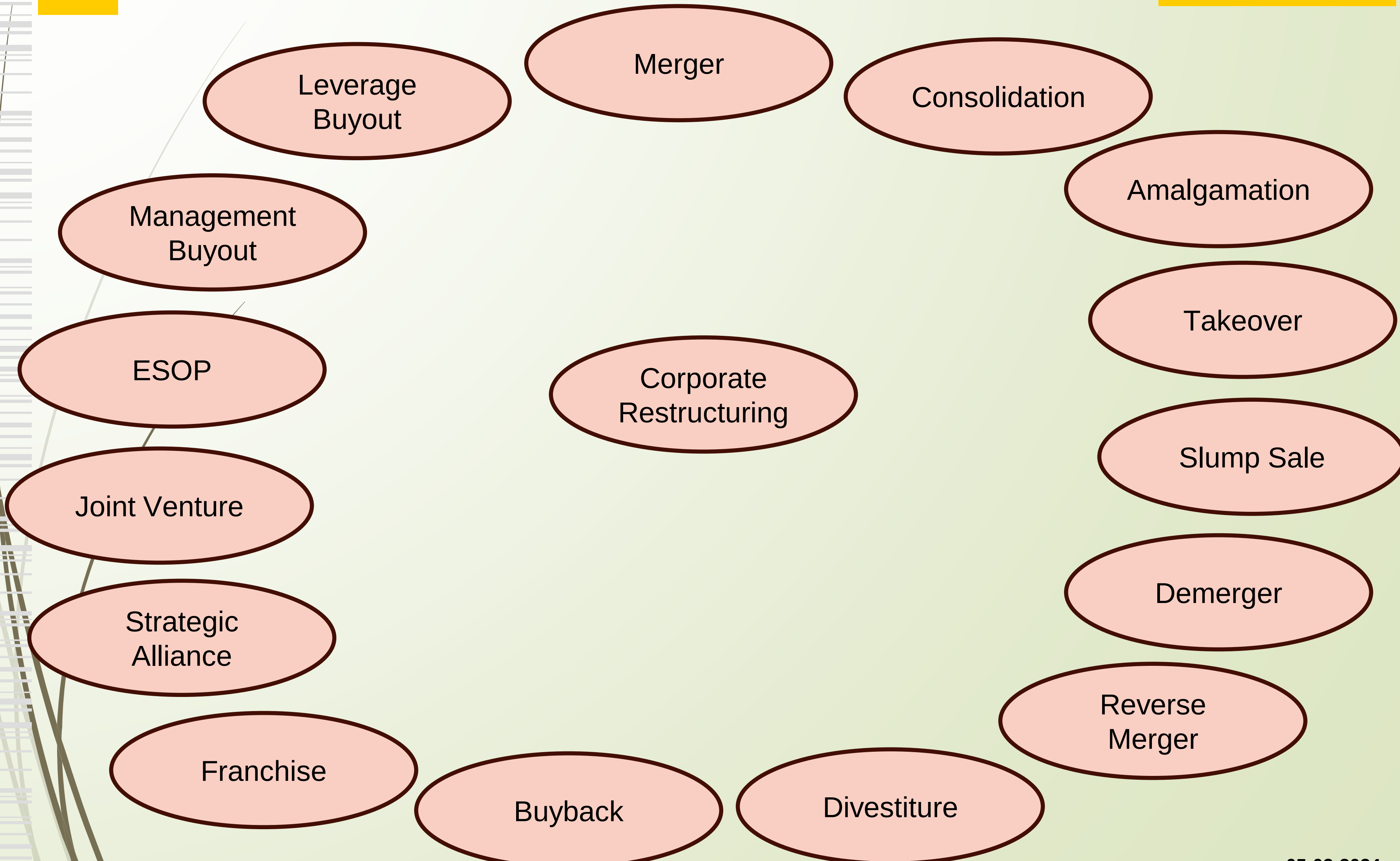
Disinvestment means the action of an organization or government selling or liquidating an asset or subsidiary. It is also known as "divestiture".

Eg.: Indian Petrochemicals Corporation Limited to Reliance Industries

Eg.: Maruti Udyog Ltd.

Eg.: Nestle sold its businesses like BabyRuth, Butterfinger and Crunch to Ferrero.

Types of Corporate Restructuring



Buyback

A company whether public or private, may purchase its own shares or other specified securities.

Eg.: Cheviot Company Limited (June 2024)

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Franchise

Franchising may be defined as an arrangement where one party (franchiser) grants another party (franchisee) the right to use trade name as well as certain business systems and process, to produce and market goods or services according to certain specifications.

The franchisee usually pays a one-time franchisee fee plus a percentage of sales revenue as royalty and gains.

Eg.: Mc Donalds, Barista, Dunkin Donuts.

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Joint Venture

A joint venture is a business or contractual arrangement between two or more parties which agree to pool resources for the purpose of accomplishing a specific task may be a new project or any other business activity.

- Eg.: Maruti Suzuki

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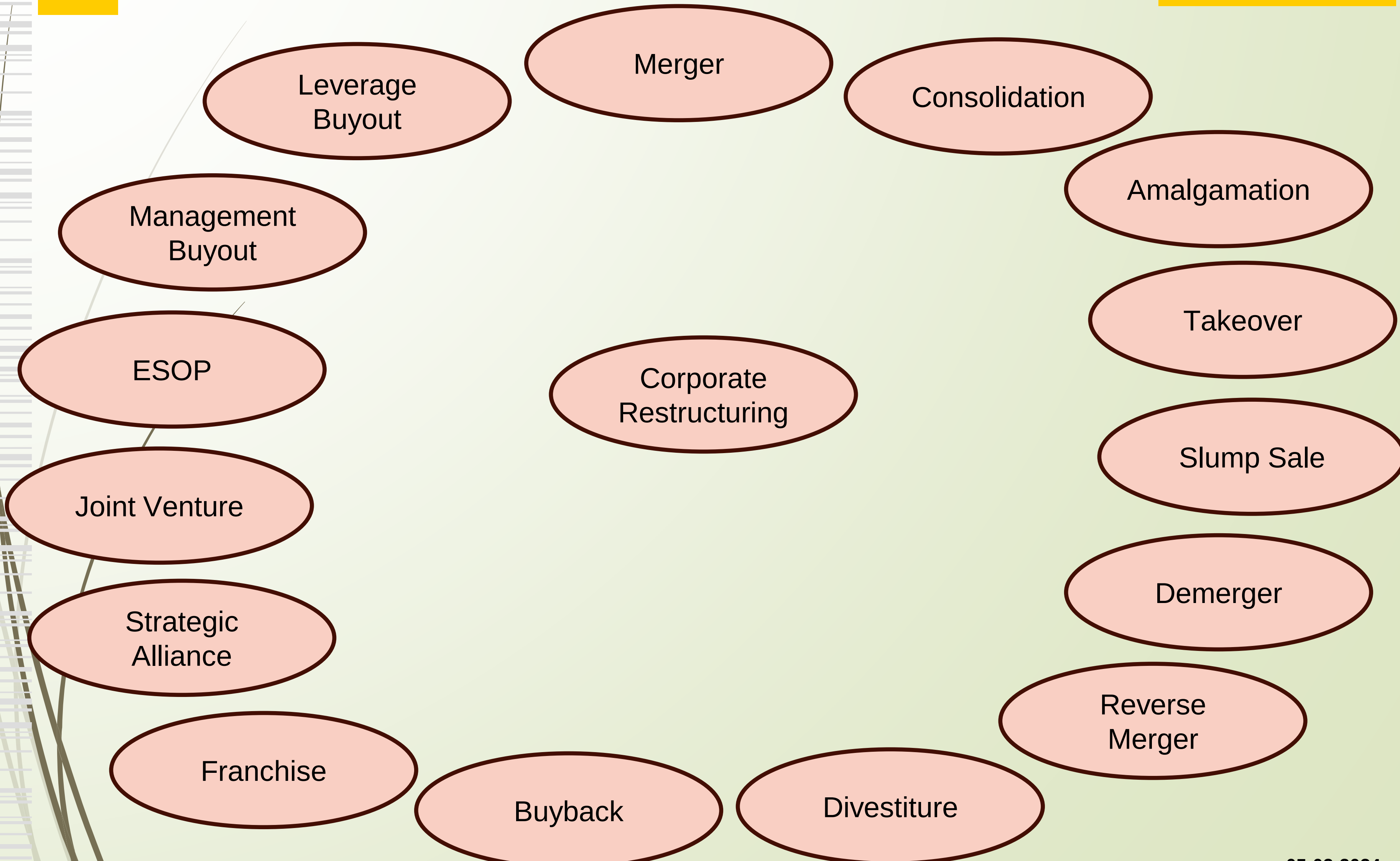
Strategic Alliance

A strategic alliance is an arrangement between two companies that have decided to share resources to undertake a specific, mutually beneficial project. It is an excellent vehicle for two companies to work together profitably. It can help companies develop and exploit the unique strengths. Organizations get an opportunity to widen customer base or utilize the surplus capacity.

Eg.: Mobile Commerce Solutions Ltd. (MCSL)
Eg.: ICICI Bank and Vodafone India – mobile money transfer and payment service – m-pesa

Types of Corporate Restructuring

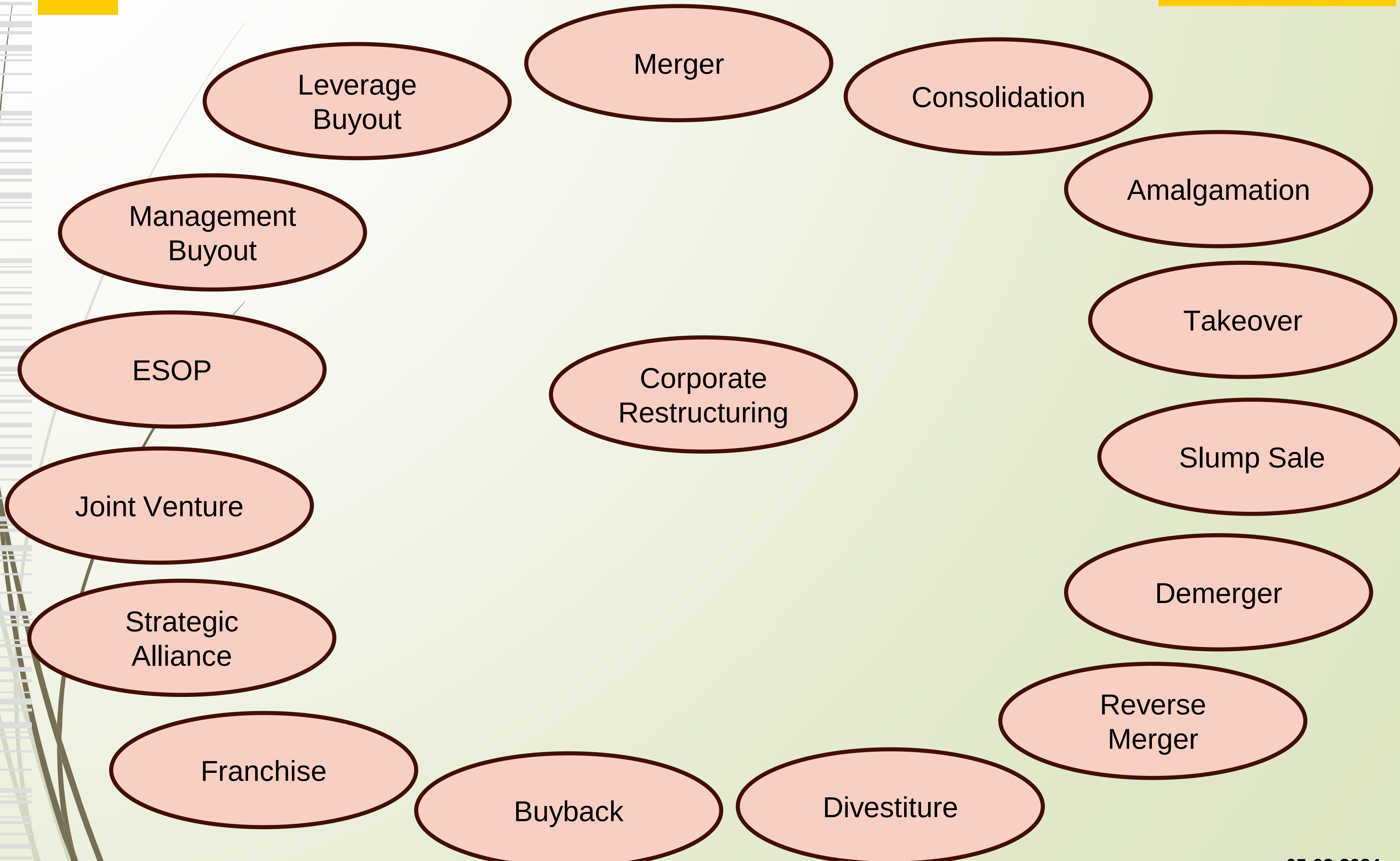


ESOP

An Employee Stock Ownership Plan (ESOP) refers to an employee benefit plan that gives the employees an ownership stake in the company. The employer allocates a certain percentage of the company's stock shares to each eligible employee at no upfront cost. The distribution of shares may be based on the employee's pay scale, terms of service, or some other basis of allocation.

Eg.: Zomato

Types of Corporate Restructuring



Leverage Buyout

A leveraged buyout (LBO) is a way of buying or acquiring a company with mostly borrowed money, often using the target's own assets as collateral.

Suited for: Companies that are mature, stable, non-cyclical, predictable. So Predictable and steady cash flows are important.

Eg.: Tata Tea & Tetley

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Management Buyout

A management buyout (MBO) is a transaction where the management team of an operating company acquires the business by borrowing money to buy out the current owner(s).

An MBO transaction is a type of leveraged buyout (LBO) and can sometimes be referred to as a leveraged management buyout (LMBO).

Joint Venture Examples

- Vistara airlines is an Indian Joint Venture with a foreign company. Vistara is the brand name of Tata SIA Airlines Ltd., a JV between India's corporate giant Tata Sons and Singapore Airlines (SIA).
- Tata Starbucks Pvt. Ltd is a joint venture of Tata with Starbucks Corporation, USA which runs a chain of Starbucks brand coffee shops across India.
- Tata AIG Insurance
- Kotak Mahindra
- Maruti Suzuki
- Hero Honda

Joint Venture

A joint venture (JV) is a business or contractual arrangement between two or more parties which agree to pool resources for the purpose of accomplishing a specific task may be a new project or any other business activity.
In a joint venture (JV), each of the participants is responsible for profits, losses and costs associated with it. Company enters into a joint venture when it lacks required knowledge, human capital, technology or access to a specific market that is necessary to be successful in pursuing the project on its own.

The joint venture can be organised as a partnership, corporation, any other form of business organisation.

Characteristics of Joint Venture

- Contribution by partners of money, property, effort, knowledge, skill, or other asset to a common undertaking.
- Joint property interest in the subject matter of the venture.
- Right of mutual control or management of the enterprise.
- Expectation of profit, or presence of adventure
- Right to share in the profit.
- Usually limit the objective to a single undertaking or ad-hoc enterprise.

Types of Joint Venture

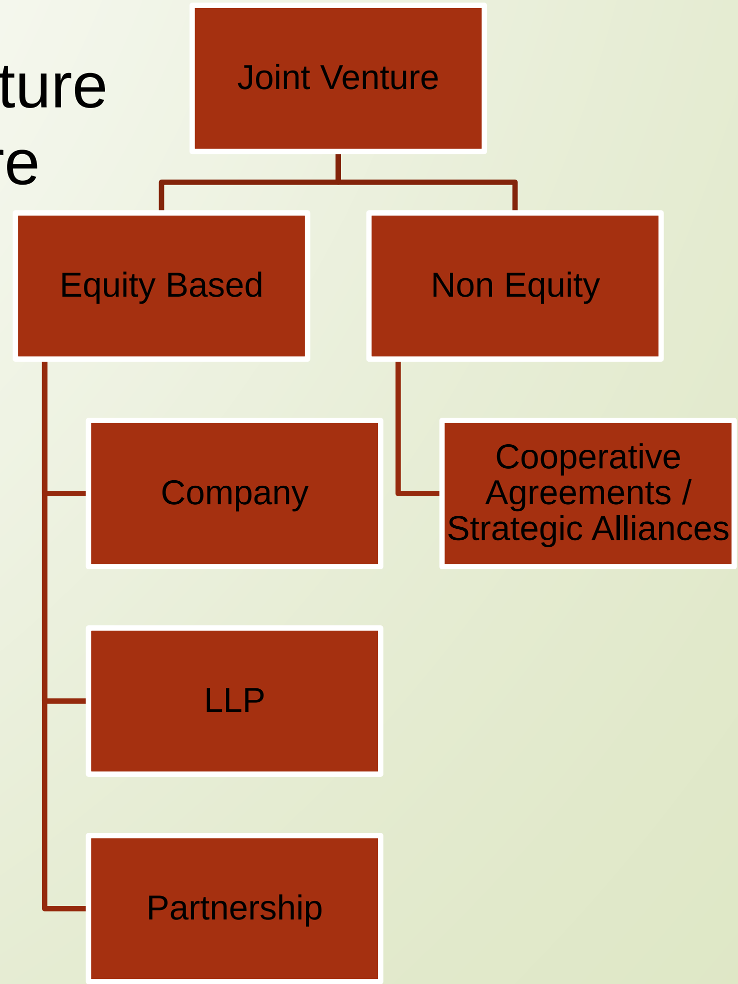
JV may be Project based joint venture or Functional based joint venture.

- **Project based Joint venture:** The joint venture entered into by the companies in order to achieve a specific task is known as project based JV.
- **Functional based Joint venture:** The joint venture entered into by the companies in order to achieve mutual benefit is known as functional based JV.

Types of Joint Venture

The two options available for establishing a joint venture in India are:

- Equity-based joint venture
- Non equity joint venture



Types of Joint Venture –
Equity Based Joint Venture

- Two or more parties set-up a separate legal company to act as the vehicle for carrying out the project.
- This new company would usually be located in the same country as one of the two partner companies, with the purpose of mutually establishing an activity with its own objectives: marketing and distribution, research, manufacturing, etc.
- The form of business entity may vary – company, partnership firm, trusts, LLPs, venture capital funds etc. From the point of a foreign company, the most preferable form of business entity is either a company or a limited liability partnership firm.

Characteristics of Equity Based Joint Venture

The key characteristics of equity-based joint ventures are as following:

a) There is an agreement to either create a new entity or for one of the parties to join into ownership of an existing entity
b) Shared ownership by the parties involved
c) Shared management of the jointly owned entity
d) Shared responsibilities regarding capital investment and other financing arrangements.
e) Shared profits and losses according to the Agreement.

Types of Joint Venture – Non Equity Joint Venture

- Also known as cooperative agreements.
- Technical service arrangements, franchise, brand use agreements, management contracts, rental agreements, or one-time contracts, e.g., for construction projects, non-equity arrangements in which some companies are in need of technical services or technological expertise than capital. It may be modernizing operations or starting new production operations.

In a contractual / non equity joint venture, a new joint agreement to work together is made but there is no agreement to give birth to an entity owned by the parties who are working together. The two parties do not share ownership of the business entity but each of the two parties exercises some elements of control in the joint venture.

Characteristics of Non Equity Joint Venture

a) Two or more parties have a common intention – of running a business venture
b) Each party brings some inputs
c) Both parties exercise some controls on the business venture
d) The relationship is not a transaction to transaction relationship but has a character of relatively longer duration.

Structure / Forms of Equity Based JV

- Company
- Partnership Firm
- Limited Liability Partnership Firm
- Venture Capital Fund
- Trusts
- Investment Vehicle
- Other Entities

Structure / Forms of Equity Based JV

- Company
- Partnership Firm
- Limited Liability Partnership Firm
- **Venture Capital Fund:** A duly registered Foreign Venture Capital Investor is allowed to contribute up to 100% in Indian Venture Capital Undertakings / Venture Capital Funds / other companies.
- Trusts
- Investment Vehicle
- Other Entities

Structure / Forms of Equity Based JV

- Company
- Partnership Firm
- Limited Liability Partnership Firm
- Venture Capital Fund
- **Trusts:** A foreign company is **not allowed** to use Trust as a form of a joint venture entity in India.
- Investment Vehicle
- Other Entities

Structure / Forms of Equity Based JV

- Company
- Partnership Firm
- Limited Liability Partnership Firm
- Venture Capital Fund
- Trusts
- **Investment Vehicle:** SEBI has introduced regulations for some funds like Real Estate Investments Trusts, Infrastructure Investment Funds, Alternative Investment Funds. Such funds are now permitted to receive foreign investment from a person resident outside India.
- Other Entities

Structure / Forms of Equity Based JV

- Company
- Partnership Firm
- Limited Liability Partnership Firm
- Venture Capital Fund
- Trusts
- Investment Vehicle
- **Other Entities:** Foreign companies are **not allowed** to use any structures other than those mentioned above for the purpose of equity based joint venture entities.

Prohibited Sectors for Equity-based JV

Foreign companies are not permitted to establish joint ventures in the following areas:

- Lottery Business
- Gambling and Betting
- Chit Funds
- Nidhi Company
- Trading in Transferable Development Rights
- Real Estate business or construction of farm houses
- Manufacture of tobacco products and substitutes
- Activities / sectors not open to private sector investment e.g. Atomic Energy and Railway Operations (excluding permitted areas of Railway Infrastructure)

Advantages of JV

- Increase resources and production capacity
- Access to new markets
- Access to latest technology
- Innovations
- Low cost of production
- Establish a brand name
- Create synergy
- Reduce risk

Disadvantages of Joint Venture

1. Frustrating experience and ultimately a failure if it lacks adequate planning and strategy.
2. Factors such as marketplace developments, technology issues, regulatory uncertainties and economic downturns can be difficult to anticipate and can have worse impact on IJVs.
3. Profits derived from an IJV are diluted because they are shared.
4. Management issues can arise because of different management philosophies of the partners.
5. May not flexible enough to change and accommodate the evolving needs of the business.

Disadvantages Of Joint Venture Contd.

6. Joint ventures are often difficult to capitalize as an entity, particularly in respect to debt, because they are finite in their duration and therefore lack permanence.
7. Unless an IJV is adequately capitalized, its debt financing, if available at all, may have to be guaranteed, in whole or in part, by the joint venture partners, which can increase their level of risk in the venture.
8. Possibility of the creation of a competitor or a potential competitor in the form of one's own joint venture partner.

Problems faced by JV

- Inability to gauge the market prospects
- Closure of Joint Venture
- Conflict of interest
- Competing against your JV partners on other projects
- Lack of joint venture experience
- Finding suitable and reliable partners

Strategic Alliance

Any arrangement or agreement under which two or more firms cooperate in order to achieve certain commercial objectives is referred to as strategic alliance. A true strategic alliance is a written arrangement between two companies that complement each other in a particular identified area. it is a commitment by the two companies to provide capabilities or cross servicing in certain identified areas.

“A strategic alliance is a strategic cooperation between two or more organizations, with the aim to achieve a result one of the parties cannot (easily) achieve alone.”

Joint Ventures and Strategic Alliance

Merriam-Webster Collegiate Dictionary, tenth edition defines alliances as:

“associations to further the common interests of the members’ or inter corporate agreements covering a wide gamut of functions ranging from component sourcing through research and development to production and marketing.”

Joint Ventures and Strategic Alliance

According to Yoshino (1995) Strategic alliance has three distinguishing characteristics:

- the two or more firms that unite to pursue a set of agreed goals remain independent subsequent to the formation of an alliance.
- the partner firms share the benefits of the alliance and control over the performance of assigned tasks.
- the partner firms contribute on a continuing basis in one or more key strategic areas e.g. technology, products and so forth.

Advantages of Strategic Alliance

There are many specific advantages of a global strategic alliance.

- Instant market access, or entry into a new market.
- Exploit new opportunities to strengthen position in a market where firm already has a foothold.
- Increase sales.
- Gain new skills and technology.
- Develop new products at a profit.
- Share fixed costs and resources.
- Enlarge distribution channels.
- Broaden business and political contact base.
- Gain greater knowledge of international customs and culture.
- Enhance image in the world marketplace.

Disadvantages of Strategic Alliance

There are also some inevitable disadvantage of strategic alliances:

- Weaker management involvement.
- Fear of market insulation due to local partner’s presence.
- Less efficient communication.
- Poor resource allocation.
- Difficult to keep objectives on target over time.
- Loss of control over important issues such as product quality, operating costs, employees, etc.

Types of Strategic Alliances

On the basis of type of industry

i. ***Horizontal strategic alliance*****:** Strategic alliance which is characterized by the collaboration between two or more firms in the same industry, e.g. the partnership between Sina Corp (Tech/online) and Yahoo in order to offer online auction services in China.

ii. ***Vertical strategic alliance***: Strategic alliance which is characterized by the collaboration between two or more firms along the vertical chain of industry. e.g. Caterpillar's provision of manufacturing services to Land Rover.

iii. ***Intersectoral strategic alliance*****:** Strategic alliance characterized by the collaboration between two or more firms neither in the same industry nor related through the vertical chain, e.g. the cooperation of Toys "R" in US with McDonald's in Japan resulting in Toys "R" US stores with built-in McDonald's restaurants.

Example of Multi-Company Strategic Alliance

A six-company strategic alliance was formed between Apple, Sony, Motorola, Philips, AT&T and Matsushita to form General Magic Corporation to develop Telescript communications software.

Case Study
Air India & Lufthansa Strategic Alliance

Lufthansa and Air India significantly improved their market leadership positions on India-Europe-USA routes with the Strategic Alliance agreement signed between Lufthansa & Air India. From 1st October 2004, Air India has been a partner of Lufthansa. Within the scope of an extensive agreement covering a far-reaching bilateral cooperation, Wolfgang Mayrhuber, Chairman of the Executive Board of Deutsche Lufthansa AG, and V. Thulasidas, Chairman & Managing Director of Air India, signed a Strategic Alliance agreement in Mumbai. The objective of the partnership was expansion of the offer of flights between Germany and India. All flights between the two countries were operated by the two airlines in code-sharing. New routes were added.

Case Study

Air India & Lufthansa Strategic Alliance

Through the cooperation in the area of frequent flyer programs, customers on flights of both airlines can collect and redeem miles for the respective programmes - Miles & More and Flying Returns. Air India has been accorded the IOSA10 (IATA Operational Safety Audit) Audit Certificate by IATA11 (International Air Transport Association) which puts it in the league of a dozen Airlines conforming to quality standards required for joining Global Alliances.

Case Study

Air India & Lufthansa Strategic Alliance

India - Germany/ Europe and India-USA are very important markets for Air India which it plans to serve over Frankfurt. IOSA (International Civil Aviation Organisation) – A specialized agency of the United Nations whose objective is to develop the principles and techniques of international air navigation. IATA (International Air Transport Association) – A trade association serving airlines, passengers, shippers, travel agents alliance with Lufthansa. In addition to the code-sharing between Germany and India, the code of Air India will also be bookable on Lufthansa connecting flights from Frankfurt to Berlin, Munich, Stuttgart and Düsseldorf to Amsterdam, Geneva, Zurich and Lyon as well as to Washington, Denver, Detroit, Chicago and Los Angeles.

Case Study

Air India & Lufthansa Strategic Alliance

This cooperation agreement results from a memorandum of understanding which the two carriers signed on 26th August 2003. In it, cooperation in the area of sales and marketing is also foreseen as well as cooperation in the medium term in other areas, for example, in the area of IT.

Case Study

Air India & Lufthansa Strategic Alliance

Lufthansa which was flying from Frankfurt to Delhi (once daily), Mumbai (once daily), Chennai (once daily) and Bangalore (five times a week) as well as from Munich to Delhi (three times a week.) would fly further six weekly flights between Frankfurt and Mumbai as well as three weekly flights between Frankfurt and Delhi which are operated by Air India and can be booked with a Lufthansa code. Air India served up to 33 destinations from Mumbai and Delhi, including, among others, Frankfurt, Chicago and New York.

Case Study

Air India & Lufthansa Strategic Alliance

The fleet of Air India consists of 33 wide bodied aircraft and it had planned to add more to make its Los Angeles & Chicago flights daily. It has also planned to operate daily services between London and Mumbai & London and Delhi and link Bangalore with Frankfurt four times a week from March 2005. The Lufthansa - Air India pact paves the way for joint development of air services on India-Europe-USA route.

Merger

Merger is the combination of two or more companies which can be merged together either by way of absorption or by formation of a new company.

Types of Mergers

Horizontal: It is a merger of two or more companies that compete in the same industry. It is a merger with a direct competitor and hence expands as the firm's operations in the same industry.

Horizontal mergers are designed to achieve economies of scale and result in reducing the number of competitors in the industry.

- Eg.: Vodafone India and Idea Cellular Limited

Types of Mergers Contd.

Vertical Merger: It is a merger which takes place upon the combination of two companies which are operating in the same industry but at different stages of production or distribution system. If a company takes over its supplier/producers of raw material, then it may result in backward integration of its activities. On the other hand, forward integration may result if a company decides to take over the retailer or Customer Company. Vertical merger provides a way for total integration to those firms which are striving for owning of all phases of the production schedule together with the marketing network.

- Forward
- Backward

Types of Mergers Contd.

Vertical Merger:

- Backward: Amazon became vertically integrated backward when it expanded its business to become both a book retailer and a book publisher.
- Forward: Luxottica, an Italian company, began as a small workshop, making components for the optical industry. Through the 1960s it grew vertically, so that by 1970 it was selling complete glasses to independent distributors. In the 1970s it began acquiring other firms, and it continued to expand internationally in the 1980s. In 1995 it bought U.S. Shoe Company to gain access to its LensCrafters subsidiary. Other acquisitions followed – Ray-Ban in 1999, Sunglass Hut in 2001 and Oakley in 2007.

Types of Mergers Contd.

Congeneric Merger: It is the type of merger, where two companies are in the same or related industries but do not offer the same products, but related products and may share similar distribution channels, providing synergies for the merger. The potential benefit from these mergers is high because these transactions offer opportunities to diversify around a common case of strategic resources.

- Eg.: Dell - EMC online data storage company

Types of Mergers Contd.

Conglomerate Merger: These mergers involve firms engaged in unrelated type of activities i.e., the business of two companies are not related to each other horizontally or vertically. In a pure conglomerate, there are no important common factors between the companies in production, marketing, research and development and technology. Conglomerate mergers are merger of different kinds of businesses under one flagship company.
The purpose of merger remains utilization of financial resources enlarged debt capacity and also synergy of managerial functions. It does not have direct impact on acquisition of monopoly power and is thus favoured throughout the world as a means of diversification.
Eg.: General Electric: Aviation, Current, Digital, Energy Connections, Global Research, Healthcare, Lighting, Oil and Gas, Power, Renewable Energy, Transportation, and Capital which cater to the needs of Financial services, Medical devices, Life Sciences, Pharmaceutical, Automotive, Software Development and Engineering industries.

Takeover

Takeover occurs when an acquirer takes over the control of the target company. It is also known as acquisition. Normally this type of acquisition is undertaken to achieve market supremacy. It may be friendly or hostile takeover.

- **Friendly takeover:** In this type, one company takes over the management of the target company with the permission of the board.
- **Hostile takeover:** In this type, one company takes over the management of the target company without its knowledge and against the wish of their management.

Objects of a takeover

The objects of a takeover may inter alia be:

1. To effect **savings in overheads** and other working expenses on the strength of combined resources;
2. To achieve **product development** through acquiring firms with compatible products and technological / manufacturing competence, which can be sold to the acquirer's existing marketing areas, dealers and end users;
3. To **diversify** through acquiring companies with new product lines as well as new market areas, as one of the entry strategies to reduce some of the risks inherent in stepping out of the acquirer's historical core competence;
4. To **improve productivity and profitability** by joint efforts of technical and other personnel of both companies as a consequence of unified control;

Objects of a takeover contd.

The objects of a takeover may inter alia be:

5. To **create shareholder value and wealth** by optimum utilisation of the resources of both companies;
6. To achieve **economy** of numbers by mass production at economical costs;
7. To secure advantage of **vertical combination** by having under one command and under one roof, all the stages or processes in the manufacture of the end product, which had earlier been available in two companies at different locations, thereby saving loading, unloading, transportation costs and other expenses and also by affecting saving of time and energy unnecessarily spent on excise formalities at different places and stages;

Objects of a takeover contd.

The objects of a takeover may inter alia be:

8. To secure **substantial facilities** as available to a large company compared to smaller companies for raising additional capital, increasing market potential, expanding consumer base, buying raw materials at economical rates and for having own combined and improved research and development activities for continuous improvement of the products, so as to ensure a permanent market share in the industry;
9. To increase **market share**;
10. To achieve **market development** by acquiring one or more companies in new geographical territories or segments, in which the activities of acquirer are absent or do not have a strong presence.

Kinds of Takeover

- Friendly Takeover
- Hostile Takeover
- Bail out Takeover
- Reverse Takeover

Kinds of Takeover

- ***Friendly Takeover**:* Friendly takeover is with the consent of taken over company. In friendly takeover, there is an agreement between the management of two companies through negotiations and the takeover bid may be with the consent of majority or all shareholders of the target company. This kind of takeover is done through negotiations between two groups. Therefore, it is also called **negotiated takeover**.
- ***Hostile Takeover**:* When an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues efforts to gain control against the wishes of existing management.

Kinds of Takeover Contd.

- ***Bail Out Takeover:*** Takeover of a financially sick company by a profit earning company to bail out the former is known as bail out takeover.

Advantages:

- The price would be very attractive as creditors, mostly banks and financial institutions having a charge on the industrial assets, would like to recover to the extent possible.
- Banks and other lending financial institutions would evaluate various options and if there is no other go except to sell the property, they will invite bids.
- Such a sale could take place in the form by transfer of shares. While identifying a party (acquirer), lenders do evaluate the bids received, the purchase price, the track record of the acquirer and the overall financial position of the acquirer.
- Thus a bail out takeover takes place with the approval of the Financial Institutions and banks.

Kinds of Takeover Contd.

- Horizontal
- Vertical
- Conglomerate

Demerger

A demerger is a form of corporate restructuring in which the entity's business operations are segregated into one or more components. It is the converse of a merger or acquisition.

The demerger can also occur by transferring the relevant business to a new company and the company's shareholders are issued shares of.

Demerger v. Divestment

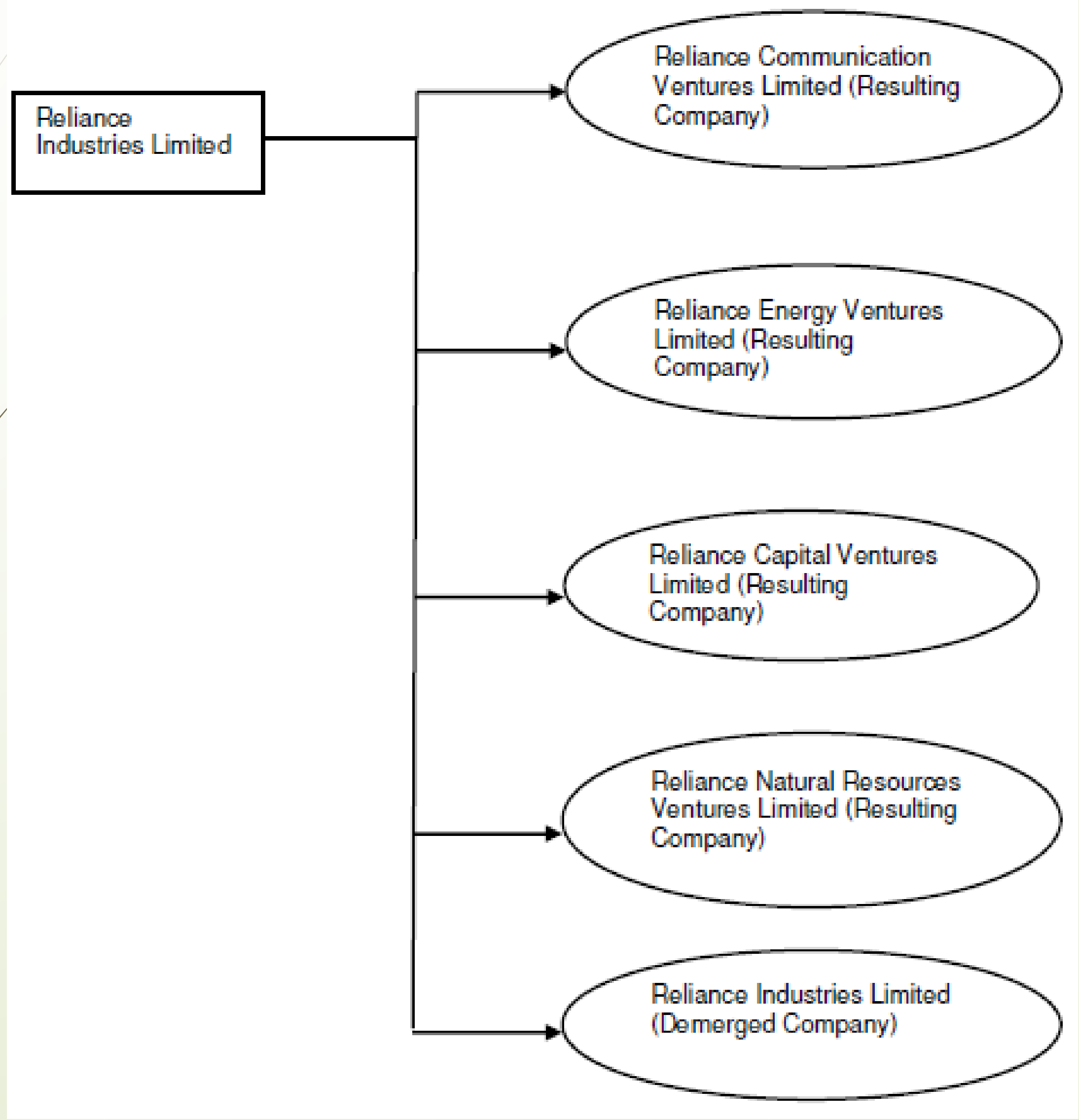
Divestment can also "undo" a merger or acquisition, but the assets are sold off rather than retained under a renamed corporate entity.

Demerger

The expression ‘demerger’ is not expressly defined in the Companies Act, 2013 (the Act). However Explanation to Section 230(1) gives a clue about the word demerger.

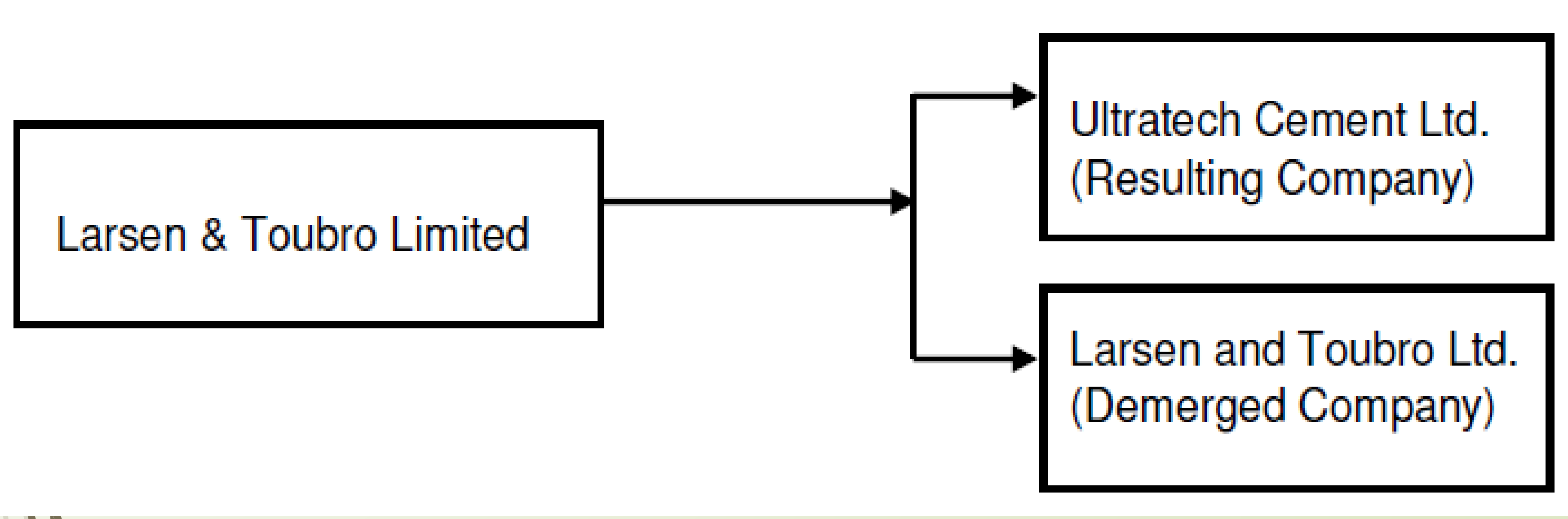
- Section 230(1) of the Act states that where a compromise or arrangement is proposed
  a) between a company and its creditors or any class of them; or
  b) between a company and its members or any class of them,
- the Tribunal may, on the application of the company or of any creditor or member of the company, or in the case of a company which is being wound up, of the liquidator, appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.

Reliance Industries Limited – Demerger of Four Units in 2005



Demerger of the cement division of Larsen and Toubro Ltd.

The demerger of the cement division of Larsen and Toubro Ltd. (L&T), named Ultratech Cement Ltd., seems to be one of the L&Ts grand strategies to concentrate more on infrastructure, engineering, energy and turnkey businesses.



Demerger under Income Tax Act 1961

The word demerger has been defined in Section 2(19AA) of the Income-tax Act, 1961 as follows:

"demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 230 to 232 of the Companies Act, 2013, by a demerged company of its one or more undertakings to any resulting company in such a manner that—

i. all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;
ii. all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
iii. the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

Demerger under Income Tax Act 1961 Contd.

iv. the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;

v. the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become share-holders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

vi. the transfer of the undertaking is on a going concern basis;

vii. the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Demerged Company and Resulting Company

- According to section 2(19AAA) of Income Tax Act ‘demerged company’ means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

- According to section 2(41A) of Income Tax Act ‘resulting company’ means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

Types of Demerger

- Partial Demerger
- Complete Demerger

Types of Demerger: Partial Demerger

One of the undertakings or a part of the undertaking or a department or a division of an existing company is separated and transferred to one or more new company/companies, formed with substantially the same shareholders, who are allotted shares in the new company in the same proportion as the separated division, department etc. bears to the total undertaking of the company.

The existing company also continues to maintain its separate legal identity and the new company, a separate legal identity, carries on the separated business and undertaking of the existing company.

Types of Demerger: Complete Demerger

- An existing company transfers its various divisions, undertakings etc. to one or more new companies formed for this purpose. The existing company is dissolved by passing a special resolution for members' voluntary winding up and also authorising the liquidator to transfer its undertakings, divisions etc. to one or more companies as per the scheme of demerger approved by the shareholders of the company by a special resolution. The shareholders of the dissolved company are issued and allotted shares in the new company or companies, as the case may be, on the basis of the pre-determined shares exchange ratio, as per the scheme of demerger.
- The existing company disappears from the corporate scene. It is voluntarily wound up and its entire business, undertakings etc. are transferred to one or more new companies.

Types of Demerger

Spin off

- Unit, division or undertaking is separated and a new wholly owned entity is created.
- Shareholders of demerged company gets proportionate share in newly created resulting company.
- Shareholders owns shares in two companies rather than just one.
- There is no money transaction involved and assets are not revalued.
- Diversification of shareholders portfolio.
- Eg.: L&T and Ultra tech Cement

Types of Demerger

Split up

- Complete demerger
- All the assets and liabilities are separated
- Liquidation of demerged company
- Eg.: AT&T 2000– AT&T Wireless, AT&T Broadband, AT&T Consumer, AT&T Business

Types of Demerger

Sell off / Divestiture

- Parent or demerged company divest a unit, division or undertaking to an existing company for cash or securities.

Types of Demerger

Equity Carve out / Split off

- Similar to spin off
- Some shares are floated to the public.
- Demerged company holds controlling interest in the resulting company.

A,B

Reverse merger

In a reverse merger, a healthy company merges with a financially weak company. The main reason for this type of reverse merger is the tax savings under the Income-Tax Act, 1961.

Section 72A ensures the tax relief, which becomes attractive for such reverse mergers, since the healthy and profitable company can take advantage of the carry forward losses of the other company. The healthy units loses its name and surviving sick company retains its name.

In the context of the Companies Act, 2013 there is no difference between a merger and a reverse merger. It is like any amalgamation.

To save the Government from social costs in terms of loss of production and employment and to relieve the Government of the uneconomical burden of taking over and running sick industrial units, Section 72A was introduced in Income Tax Act, 1961.

Salient Features of Reverse Mergers under Section 72A

1. Amalgamation should be **between the companies** and none of them should be a firm of partners or sole proprietor. In other words, partnership firm or sole-proprietary concerns cannot get the benefit of tax relief under Section 72A merger.

2. The companies entering into amalgamation should be **engaged in either industrial activity or shipping business or hotel with another company or banking business under Section 5(c) of the Banking Regulation Act, 1949 or Public Sector Companies engaged in the business of operation of aircraft**. In other words, the tax relief under Section 72A would not be made available to companies engaged in trading activities or services.

3. After amalgamation, the "**sick**" or "**financially unviable company**" shall survive and the other income generating company shall extinct. In other words, essential condition to be fulfilled is that the acquiring company will be able to revive or rehabilitate having consumed the healthy company.

Salient Features of Reverse Mergers under Section 72A Contd.

4. One of the merger partners should be **financially unviable** and have **accumulated losses** to qualify for the merger and the other merger partner should be profit earning so that tax relief to the maximum extent could be realised.

   In other words, the company which is **financially unviable should be technically sound and feasible, commercially and economically viable but financially weak because of financial stringency or lack of financial resources or its liabilities have exceeded its assets and is on the brink of insolvency.** The second requisite qualification associated with financial unviability is the **accumulation of losses for past few years**.

5. Amalgamation should be in the public interest i.e., it should not be against public policy, should not defeat the basic tenets of law, and must safeguard the interest of employees, consumers, customers, creditors and shareholders apart from the promoters of the company through the revival of the company.

Salient Features of Reverse Mergers under Section 72A Contd.

6. The merger should result into the following benefits to the amalgamated (acquired/target) company i.e.,:

(a) carry forward of accumulated business losses of the amalgamating company;

(b) carry forward of unabsorbed depreciation of the amalgamating company and

(c) accumulated loss would be allowed to be carried forward and set off for eight subsequent years under Section 72A of the Income-tax Act, from the A.Y. 2009-10, the accumulated loss or the case may be, allowance for unabsorbed depreciation of amalgamating company shall be deemed to be the loss or as the case may be, allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and other provisions of the Income Tax Act relating to set off and carry forward of loss and allowance for depreciation.

Salient Features of Reverse Mergers under Section 72A Contd.

7. Accumulated loss should arise from "Profits and Gains from business or profession" and not be loss under the head "Capital Gains" or "Speculation".
8. For qualifying carry forward loss, the provisions of Section 72 should not have been contravened.
9. Similarly for carry forward of unabsorbed depreciation the conditions of Section 32 should not have been violated.
10. Specified Authority has to be satisfied of the eligibility of the company for the relief under Section 72 of the Income-tax Act. It is only on the recommendation of the specified authority that Central Government may allow the relief.
11. The company should make an application to the "specified authority" for requisite recommendation of the case to the Central Government for granting or allowing the relief.
12. Specified Authority makes recommendation after taking into consideration the court's direction on scheme of amalgamation.

Conditions for availing tax benefit in case of reverse merger

72A of the ITA states that if sick or poorly performing company merges with healthy company benefits of carry forward of loss and unabsorbed depreciation can be availed if:

- Accumulated losses remain unabsorbed for 3 or more years.
- 75% of book value to be held at least for 3 or more years.
- Amalgamated company continues the business of the amalgamating company for not less than 5 years from the date of amalgamation.
- Amalgamated company holds at least 75% of the fixed assets (in book value) of the amalgamating company for not less than 5 years.
- New company should achieve at least 50% of installed capacity before the end of 5 years and should continue for 5 years.
- The amalgamated company is an Indian company.

Corporate Restructuring

Buyback of shares

Buyback of shares

According to Section 68(1) of the Companies Act, 2013 a company whether public or private, may purchase its own shares or other specified securities (hereinafter referred to as “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.

However, no buy-back of any kind of shares or other specified securities can be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Buyback of shares

- Thus, the company must have at the time of buy-back, sufficient balance in any one or more of these accounts to accommodate the total value of the buy-back.
- "Specified securities" as referred to in the explanation to the section includes employees' stock option or other securities as may be notified by the Central Government from time to time.
- "Free reserves" as referred to in the explanation includes securities premium account.

Buyback of shares: Authorisation 68(2)

The primary requirement is that the articles of association of the company should authorise buyback. In case, such a provision is not available, it would be necessary to alter the articles of association to authorise buyback.

Buy-back can be made:

1. with the approval of the Board of directors at a meeting and/or
2. by a special resolution passed by shareholders in a general meeting, depending on the quantum of buy back.

In case of a listed company, approval of shareholders shall be obtained only by postal ballot.

Quantum of Buyback

a) Board of directors can approve buy-back up to 10% of the total paid-up equity capital and free reserves of the company and such buy back has to be authorized by the board by means of a resolution passed at the meeting.
b) Shareholders by a special resolution can approve buy-back up to 25% of the total paid-up capital and free reserves of the company. In respect of any financial year, the shareholders can approve by special resolution upto 25% of total equity capital in that year.

Post buy-back debt-equity ratio

- The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves i.e., the ratio shall not exceed 2:1. However, the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;
- All the shares or other specified securities for buy-back are to be fully paid-up.

Buyback by listed/unlisted companies

- The buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board in this behalf; and
- The buy-back in respect of shares or other specified securities other than listed securities in is in accordance with such rules made under Chapter IV of the Companies Act, 2013.

Time gap

- No offer of buy-back shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back, if any.

Explanatory statement 68 (3)

The notice of the meeting at which the special resolution is proposed to be passed under clause (*b*) of sub-section (*2*) section 68 shall be accompanied by an explanatory statement stating—

a) a full and complete disclosure of all material facts;
b) the necessity for the buy-back;
c) the class of shares or securities intended to be purchased under the buy-back;
d) the amount to be invested under the buy-back; and
e) the time-limit for completion of buy-back.

Time limit for completion of buyback [Section 68(4)]

Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board.

Methods of buy-back [Section 68(5)]

The buy-back may be:

a) from the existing shareholders or security holders on a proportionate basis;
b) from the open market;
c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Section 68(6)

Where a company proposes to buy-back its own shares or other specified securities under this section in pursuance of a special resolution under clause (*b*) of sub-section (*2*) or a resolution under item (*ii*) of the proviso thereto, it shall, before making such buy-back,

file with the Registrar and the Securities and Exchange Board, a **declaration of solvency** signed by at least two directors of the company, one of whom shall be the managing director, if any, in such form as may be prescribed and verified by an **affidavit** to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board:

Provided that no declaration of solvency shall be filed with the Securities and Exchange Board by a company whose shares are not listed on any recognised stock exchange.

Extinguishment of securities bought back [Section 68(7)]

When a company buys back its own shares or other specified securities, it shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back.

Prohibition of further issue of shares or securities [Section 68(8)]

When a company completes a buy-back of its shares or other specified securities **it shall not make a further issue of the same kind of shares or other securities** including allotment of new shares under clause (a) of sub-section (1) of section 62 or other specified securities **within a period of six months except by way of a 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.

Register of buy-back [Section 68(9)]

When a company buys back its shares or other specified securities, it shall maintain a register of the shares or securities so bought,

- the consideration paid for the shares or securities bought back,
- the date of cancellation of shares or securities,
- the date of extinguishing and physically destroying the shares or securities and
- such other particulars as may be prescribed.

- According to the rules [Rule 17(12)] the register of shares or securities bought back shall be maintained in Form SH-10, at the **registered office** of the company and shall be kept in the **custody of the secretary** of the company or any other person authorized by the board in this behalf. Entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.

Return of Buyback [Section 68(10)]

- A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board (in case of listed companies) a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed.
- The company shall file with the Registrar, and in case of a listed company with the Registrar and the SEBI, a return in the Form No. SH-11 along with the 'fee'. There shall be annexed to the return filed with the Registrar in Form No. SH-11, a certificate in Form No. SH- 15 signed by two directors of the company including the managing director, if any, certifying that the **buy-back of securities has been made in compliance with the provisions of the Ac**t and rules made thereunder. **[Rule 17(13) and Rule 17(14)]**

Penal Provisions [Section 68(11)]

If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board, in case of listed companies, the company shall be punishable with fine which shall:

- not be less than **one lakh rupees** but which may extend to **three lakh rupees** and

every officer of the company who is in default shall be punishable:

- with imprisonment for a term which may extend to **three years** or with fine which shall not be less than **one lakh rupees** but which may extend **to three lakh rupees**, or with both.

Transfer to and application of Capital Redemption Reserve Account: (Section 69)

When a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the **capital redemption reserve account** and details of such transfer shall be disclosed in the balance sheet.

The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Circumstances prohibits buy-back

Under Section 70(1) of the Companies Act, 2013, no company shall directly or indirectly purchase its own shares or other specified securities-

- through any subsidiary company including its own subsidiary companies;
- through any investment company or group of investment companies; or
- if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company.

However, the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist.

Circumstances prohibits buy-back

Under Section 70(2) of the Companies Act, 2013, no company shall directly or indirectly purchase its own shares or other specified securities:

- in case such company has not complied with the provisions of sections
  - 92(Annual Return),
  - 123(Declaration of Dividend),
  - 127(punishment for failure to distribute dividend) and
  - 129 (Financial Statement)