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UNIT - I

LESSON

1

Basics of Corporate Restructuring

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STRUCTURE

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1.1 Learning Objectives

- Understand the concept and importance of corporate restructuring for growth.
- Understand how firms can restructure.
- Understand all the basics of corporate restructuring.

1.2 Introduction

The world's economy has been experiencing massive conflicts, which is reflected in the rapid growth of mergers and acquisitions that have occurred in recent years. The main factors that drive mergers and acquisitions as well as restructuring operations are advancements in technology, communication, transportation, market size, types and levels of competition, legislation, and the financial and economic climate. It is not sufficient for businesses to just adapt to these changes; instead, they must outperform their rivals and develop new ideas in order to consistently maximize shareholder wealth.

Restructuring corporations has benefited a number of organizations. Growth is the primary goal of business reorganization. Company's growth strategy can be broadly divided into two categories: organic and inorganic.

Organic Strategies: The term "organic strategies" refers to internal growth plans, which concentrate on asset replication, technological exploitation, improved customer relationships, and the development of new products and technologies to close market gaps. It is a few-year-long, steady growing process.

Inorganic Strategy: External growth through takeovers, mergers, and acquisitions is referred to as an inorganic strategy. It is quick and enables the instant use of assets that have been bought.

It is stated that mergers and acquisitions are essential strategic instruments for growing product lines, breaking into untapped markets, obtaining cutting-edge technology, and creating organizations of the next generation with the strength and resources to compete on a global scale.

As a result, businesses view inorganic initiatives as quick fixes for expanding and releasing wealth for investors. Indian industry has been

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subjected to heightened levels of domestic and international rivalry since 1991. In order to remain competitive and provide value to stakeholders, the Indian corporate sector has been compelled to reorganize and reengineer. The fact that BRIC (Brazil, Russia, India, and China) has shifted and redistributed economic power emphasizes how deeply ingrained India is in the rapidly changing multipolar global economy.

The steel, aluminum, cement, automobile, banking and finance, food products, pharmaceuticals, consumer durables, computer software, agro-chemicals, and textile industries have all seen a significant increase in mergers and acquisitions activity.

1.3 Corporate Restructuring

The term "corporate restructuring" refers to a business entity's major modification of its capital structure or activities. Corporate restructuring typically takes place when a company is facing serious issues and faces financial instability.

Almost any modification to ownership, operations, or capital structure that takes place outside of the regular course of business is referred to as corporate restructuring.

The two categories of corporate restructuring are financial and operational.

(i) The term "operational restructuring" describes the full or partial acquisition or sale of businesses or product lines or cutting costs by closing non-strategic and ineffective sites.

(ii) Financial restructuring describes the steps that the organization has taken to alter the composition of the company's overall debt and equity.

1.4 Reasons for Corporate Restructuring

The following circumstances lead to the implementation of corporate restructuring:

1. **Change in Strategy:** In an effort to boost performance, the management of the troubled company has gotten rid of some subsidiaries and divisions that don't fit with the company's main plan. It's possible that the division or subsidiaries don't seem to strategically align with

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the long-term goals of the business. As a result, the corporate entity chooses to sell these assets to possible buyers while concentrating on its primary plan.

2. **Lacking of Profits:** The project might not generate enough revenue to meet the company's capital costs and could result in financial losses. The venture's inadequate performance could be the consequence of an inadequate judgment made by management to launch the division or a reduction in the venture's profitability based on by shifting consumer needs or rising expenses.
3. **Reverse Synergy:** This idea goes against the synergy principles, which state that the combined worth of the individual units exceeds their total value. Reverse synergy states that a single unit's worth could exceed that of a combined unit. This is among the various justifications for selling the company's assets. The party in question may determine that selling a division to a third party will provide a higher price than keeping it in-house.
4. **Cash Flow Requirement:** Eliminating an unsuccessful project can bring in a sizable amount of cash for the business. Selling an asset is one way to raise money and not to be in debt, if the corporate entity is in question or having difficulty in getting finances.
5. **Global Competitive Strength:** The capacity and size of Indian corporates are relatively small. To remain competitive, Indian firms need to expand their capacity, introduce new technologies, and cultivate export markets. Labor costs are reduced by deregulation and globalization, which also makes markets more accessible to a large number of producing companies. Indian businesses have experienced the need to go global in order to survive. The easiest way to gain worldwide competitive power and expand quickly in the generic industry is through mergers and acquisitions.
6. **Sustainable Growth:** A company's ability to maintain its viability, dynamism, and capacity to enhance value depends on its growth. Growth could potentially result in increased earnings and value for shareholders. By entering new markets and expanding into current ones, a business can reach its growth goal.

   Through mergers, a company might obtain more resources from other sources, including production facilities. Growth can be acquired

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more easily through mergers than by using a construction strategy. Purchasing a company that manufactures a product is a far easier option for a company looking to enhance production capacity than starting from scratch. Internal expansion takes time and necessitates operational infrastructure for things like production, research, and marketing. It takes time for internal growth facilities to mature. Thus, the company's potential for growth is limited by a shortage of resources or an inadequate amount of time needed for internal development. Through mergers and acquisitions, the business can get production facilities and other external resources.

7. **Surplus Cash:** A business with a lot of cash on hand could experience a distinct scenario. It might not have enough opportunity within the company to put its extra money to use. It might use the extra money to buy another business or give it to its stockholders. If the excess cash is returned to the shareholders, they might not really gain anything because they would be subject to ordinary income tax rates. If excess cash is utilized to buy another company, their wealth can rise due to a surge in the market value of their shares.
8. **Increased Market Power:** The combined company's market share may rise as a result of the merger. Increased market share or concentration boosts the company's profitability due to scale-related economies. Additionally, the firm's negotiating leverage with suppliers and labor is strengthened. In addition, the combined company can take advantage of technology advancements to combat price wars and obsolescence. Therefore, the combined company may generate super-normal profit and effectively use the extra cash to strengthen its position and increase its market dominance.
9. **Stagnation:** When a business reaches its point of maturity, it is likely to experience an insufficient growth rate. Thus, achieving renewed growth is the aim.

   During periods of stagnation and low profitability, mergers are frequently employed as a defensive tactic. Many executives are forced by increased competition to give up their autonomy and form alliances in order to be able to stand up to themselves. The enterprises enjoy greater market authority and increased environmental efficiency due to their expanded resources and market share.

IN-TEXT QUESTIONS

1. What are the two categories of corporate restructuring?
   (a) Financial and Operational
   (b) Strategic and Tactical
   (c) Internal and External
   (d) All of these
2. What does "corporate restructuring" refer to?
   (a) Regular business activities
   (b) Small adjustment to day-to-day activity
   (c) Major modifications related to business entities
   (d) All of these

1.5 Types of Corporate Restructuring Rate

1. **Financial Restructuring:** The necessity to alter the company's financial structure leads to this restructuring. It covers debt refinancing, issuance of extra shares, and money raising. It may also happen as a result of a decline in total sales brought on by a bad economic climate. The business entity in this situation is able to modify its debt-servicing schedule, equity holdings, cross-holding pattern, and equity holdings. The purpose of doing this is to keep the market viable and the business profitable. In the end, this may help the business's financial situation.
2. **Operational Restructuring:** The company's operational structure needs to be altered, which leads to this restructuring. It involves reorganizing departments, outsourcing non-core tasks, and implementing new technology. Expanding a company's area of action and enhancing staff performance are the primary goals of this kind of restructuring. It offers operational and service enhancements that might aid businesses in getting back to their feet. In the end, this could improve the business' productivity and effectiveness.
3. **Organizational Restructuring:** The need to modify the organizational structure of the business leads to this restructuring. It entails cutting

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back on the total number of workers in the company, modifying job descriptions, bringing down the organizational hierarchy, and changing the reporting system. This kind of restructuring's primary goal is to cut expenses and settle any outstanding debt so that the company may continue operating in a particular manner.

4. **Strategic Restructuring:** The need for modifying the company's overarching strategy leads to this reorganization. It involves abandoning unsuccessful markets and entering new ones. This kind of restructuring typically aims to boost profitability by exploring new markets and supporting the long-term expansion of the business.

1.6 Types of Corporate Restructuring Strategies

1. **Merger:** It involves the absorption, fusion, or formation of a new firm from the combination of two or more corporate entities. The exchanging of assets between the intended buyer and the acquiring organization occurs during the merger of more than two business entities.

   A merger may occur by amalgamation or absorption.
2. **Demerger/Sell-Offs:** In order to capitalize on the synergies that result from a merger, two or more businesses merge into a single entity under such corporate restructuring approach. A demerger is the division of a business unit from the parent firm.
3. **Joint Venture:** In a joint venture, two businesses agree to pool their resources in order to accomplish a specific shared commercial objective. Only a small portion of the businesses activities are intersected, and usually only for a brief period of time. The venture partners divide the venture's profits in accordance with a predetermined formula. This approach is typically used by multinational corporations to join overseas markets. This tactic combines two or more businesses to create an entity that will do a financial act cooperatively.
4. **Disinvestment/Divestiture:** Disinvestment is the process by which a government agency or an organization sells off assets from the corporation or one of its subsidiaries in order to reduce its ownership position. It also entails cutting back on capital expenses in order to reallocate funds to other worthwhile endeavors supported by the

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government or an organization. Maximizing returns on investment is the main goal of disinvestment, regardless of the outcome.

5. **Strategic Alliance:** A strategic alliance is an agreement that allows multiple separate businesses to work together on projects that involve product and service development, manufacturing, sales, or other commercial goals.

   In a strategic alliance, for instance, Company A and Company B pool their resources, skills, and core competencies to create shared interests in product or service design, production, or distribution.

6. **Consolidation:** A consolidation occurs when two or more companies merge to form one single organization. Businesses frequently transform into new entities with unique brand identities. There are many reasons why businesses want to combine, but the possibility of gaining more market share and long-term cost reductions is the most common one. Businesses can gain access to new markets and decrease operational inefficiencies by merging two or more organizations into one.

1.7 Merger

A corporate strategy of merging with another business to function as one legal structure is known as a merger. Usually, the businesses that consent to mergers are of comparable sizes and operational scopes.

Mergers can be in form of:

(a) **Absorption:** The term "merger" describes the blending of one company into another; in other words, the acquiring company keeps its name and identity while acquiring all of the acquired company's assets and obligations. The purchased company goes out of business as a distinct entity. As an example, absorption happens when A Ltd. acquires control of B Ltd.'s business, leading to B Ltd.'s liquidation and leaving just A Ltd. in existence.

(b) **Amalgamation:** When two firms come together, a new company is formed; the acquiring and the newly acquired firms both end their legal existence and join the new company. The difference between the target company and the acquirer is not important in this case.

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For instance, Maruti Suzuki Limited was the new business created when Maruti Motors of India and Suzuki of Japan amalgamated.

Types of Merger

1. **Congeneric Merger:** These mergers take place between businesses that are involved in the same industry. One company's current product range gains a new addition as a result of the merger. Companies can reach a broader client base and grow their market share as a result of the union.
2. **Conglomerate Merger:** A conglomerate merger is the joining of businesses engaged in unrelated operations. Only if the union boosts the financial position of the shareholders, then only it will proceed.
3. **Market Extension Merger:** Businesses that provide the same items but operate in different markets merge to get access to a bigger market and customers.
4. **Horizontal Merger:** Businesses that operate in areas where there are fewer of these enterprises combine to expand their market. One kind of consolidation of businesses offering comparable goods or services is a horizontal merger. As there is no longer any rivalry, economies of scale are possible.
5. **Vertical Merger:** Companies that are part of the same industry but are connected at different stages of the supply chain combine to form a vertical merger. The purpose of these mergers is to improve efficiency, supply chain control, and synergies.

Advantages of Merger

1. **Expands Market Share:** When businesses combine, the resulting entity increases its market share and outperforms its rivals.
2. **Lowers Operating Expenses:** Businesses can cut costs by achieving efficiencies of scale, which includes purchasing raw materials in bulk. Technical economies are the result of asset investments being dispersed over a greater output.
3. **Prevents Duplication:** Certain companies that manufacture comparable goods might combine in order to prevent overlap and eradicate rivalry. Customers also benefit from lower prices as a result.

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4. **Extends Operations into New Regions:** To begin started, a business looking to expand in a particular region could merge together with an equivalent company already functioning there.
5. **Keeps a Losing Company from Winding up:** In addition to preventing an organization from going bankrupt, mergers can save a lot of jobs.

Disadvantages of Merger

1. **Increases the Cost of Goods or Services:** A merger increases market share while reducing competition. As a result, the new business may acquire a monopoly and raise the cost of its goods and services.
2. **Causes Communication Gaps:** It's possible that the cultures of the two businesses have decided to come together. It could lead to a communication breakdown and have an impact on workers' output.
3. **Causes Lack of Employment:** A firm may decide to get rid of the other company's underperforming assets in an aggressive merger. Employees can end up losing their employment as a result.
4. **Prevents the Development of Economies of Scale:** It could be challenging to create synergies when the companies don't have many things in common. Furthermore, a larger business might not be able to inspire workers and exert the same level of control. As a result, the new business might not be able to realize economies of scale.

1.8 De-Merger

A demerger is the division of a business into its own independent entity. What happens to the parent firm and the newly formed company depends on the type of demerger.

Types of Demerger:

1. **Spin-Offs:** A spin-off occurs when a business unit inside the parent firm is separated and given its own identity. A dividend in the form of equity in the newly formed company is paid to the parent firm's current shareholders. In a spin-off business, no money is raised because no stock is sold, but the parent firm may choose to keep a stake in the spun-off business—as long as it is not greater than 20%.

2. **Split-Off:** It could be desirable for a huge corporation with several businesses to divide them up into independent entities. Shareholders have the option to convert their Parent Co. shares into newly issued shares of the company (Split Co.) during a split-off. A premium is frequently included in this "tender offer" to entice current Parent Co shareholders to sign onto the deal.
3. **Split-Up:** In contrast to what was said above, the parent business does not survive a split-up. It is dissolved into the newly formed businesses as a result of the deal.
4. **Equity Carve-Out:** An IPO, in which certain amounts of the subsidiary's shares are sold to the public and the revenues can be kept by the subsidiary or given to the parent company, may come before spin-offs and split-offs. This refers as a carve-out.

   This particular demerger differs significantly from spin-offs and splits in that it generates financial inflows.

Advantages of Demerger

1. **Enhanced Focus on Strategy:** The separation that results from a demerger improves strategic concentration, which is its most evident advantage. Decisions about the subsidiary can be made more quickly and in closer consultation with the client when the parent business is not involved in the process. A carve out is frequently (though not always) a chance for the parent corporation to sell a non-core and maybe underperforming business unit.
2. **Enhanced Profitability:** Big corporations are intricate, frequently ineffective creatures. By breaking out the complexity into distinct entities, you can gain significant cost savings in simpler, more targeted enterprises. Profitability naturally rises as a result.
3. **Long-term Generation of Value:** Long-term growth is nearly always the result, even in cases where value for shareholders is not generated in the initial year following the merger or acquisition. This is due to the fact that shareholders of merged companies might profit from operations that are more strategically focused and have autonomous management responsibility. Share prices rise as a result, compared to what they would have if the demerger hadn't occurred.

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4. **Enhanced Openness:** Investors benefit from demerger deals because they have greater visibility into the subsidiary's activities and cash flow. This is a significant advantage that will eventually help investors make wiser choices.

Disadvantages of Demerger

1. **A Dispute among Shareholders:** If shareholders disagree with the demerger decision, shareholder disengagement is always a possibility. If Parent Co's split-off premium is judged to be unreasonable, there may even be a chance of shareholder complaints.
2. **A Sudden Decline in Stock Price:** The market value for the spun-off firm is deducted from the parent company's share price when a spin-off occurs. It is important for shareholders to be aware, nevertheless, that disinvesting only due to a demerger announcement may result in the loss of substantial future value.
3. **Needs a Lot of Planning:** A demerger is a massive project with a certain level of execution risk. Planning is nearly always more involved in separating a firm than businesses realize. In order to optimize value, careful planning is necessary.

1.9 Joint Venture

For companies wishing to expand into new markets, share risks, and improve their capabilities, launching a joint venture may serve as a wise strategic step. Businesses can take advantage of each other's assets, skills, and competencies by establishing a short-term partnership in order to accomplish shared objectives.

Types of Joint Venture

1. **Restricted Collaboration:** Working together with another firm is done in a particular method. For example, when a small company wishes to market a new product through the distribution network of a larger company, they merge their businesses. The conditions and limitations of the role are outlined in a contract that the two partners agree upon.
2. **Independent Joint Venture Company:** A distinct partnership business is created when a new company handles a contract to establish a

distinct joint venture business. The partners decide how to run the business and each owns a separate share.

3. **Commercial Alliances:** One way to merge two businesses is to enter into a limited liability partnership or business partnership. It is possible for corporations, partnerships, limited liability companies, and other commercial entities to continue in existence as a joint venture.

Advantages of Joint Venture

1. **Fresh Knowledge and Perspective:** Working together is a great method to gain access to fresh perspectives and knowledge. When you collaborate with another organization, you pool your varied expertise. This kind of cooperation can result in creative fixes and a deeper comprehension of market dynamics. Both partners' investments guarantee that each is equally dedicated to the venture's success, creating a beneficial relationship where the combined skill is greater than the individual components of its parts.
2. **Better Resources:** Each partner in a joint venture is able to provide important resources, such as money, people, and equipment. The venture's overall capacity and operating efficiency are improved by these combined resources. How these resources are used will be outlined in the joint venture agreement, guaranteeing that each contribution is optimized and skillfully overseen. This configuration frequently results in better project execution and higher success rates.
3. **This Partnership is Just Temporary:** One of a joint venture's main benefits is that it's transient. With this arrangement, businesses can work together on projects with no long-term obligations and complexities of an ongoing partnership or merger. A low-risk and flexible choice for strategic collaboration, the joint venture allows the parties to part ways with no ongoing responsibilities once the venture's defined aims are met.
4. **Joint Risks and Expenses:** The project's risks and financial load are divided among the partners. Because of this shared duty, no one party is entirely responsible for the risk or expense of failure. Partners can bargain about how to split expenses and earnings, resulting in customized agreements that take into account the skills

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and aspirations of each participant. This method of spreading risks can increase the viability and appeal of big initiatives.

5. **Adaptability:** Joint ventures provide a great deal of operational and structural flexibility. The venture's parameters are negotiable, including its lifespan, goals, and donations. Because of its flexibility, the project can be tailored to the unique requirements and objectives of the involved parties. The venture's lifespan is also flexible, and it can be changed in accordance with project milestones and changing business conditions.

Disadvantages of Joint Venture

1. **Uncertain Goals:** A joint venture cannot succeed unless its goals are precise and well-defined. Ambiguity or a lack of consensus among stakeholders can result in a lack of clarity, misdirected endeavors, and eventually, the failure of the enterprise. It is vital to guarantee that all collaborators comprehend and are dedicated to the same goals from the outset in order to avoid miscommunications and inefficiencies.
2. **Limited Adaptability**: Joint ventures may restrict the partners' flexibility. Each partner's ability to seek other business possibilities may be limited by their need to uphold the terms of the agreement and concentrate on the joint venture's goals. This lack of adaptability may prove harmful if the venture's goals diverge from the partners' strategic objectives or if the market situations change.
3. **Few External Possibilities:** Being a part of a joint venture may limit the partners' capacity to conduct other types of business. There may be provisions in the agreement for the joint venture that restrict outside possibilities in order to avoid conflicts of interest. This can help to safeguard the joint venture, but it can also impede the expansion and diversification of the separate companies.
4. **Planning and Research Are Necessary:** Meticulous planning and extensive study are necessary for joint ventures to succeed. In order to make sure that the venture's goals are reasonable and attainable, this entails conducting market research, risk analysis, and strategic alignment. Insufficient planning may result in major obstacles which could have been foreseen and avoided for the joint venture.

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5. **Inadequate Communication:** Good communication is essential to any joint venture's success. Partners may not have the same priorities or aspirations, which can cause misunderstandings and poor communication. Inadequate and inconsistent communication can lead to missed opportunities, project delays, and eventually the joint venture's demise. Creating strong communication protocols is one way to deal with this problem.
6. **Unreliable Partners:** A joint venture's potential to succeed largely depends on how dependable and committed each partner is. The endeavor as a whole may suffer if one of the individuals does not invest enough time and money. This risk can be reduced by choosing partners that have a track record of dependability and by setting up explicit guidelines and accountability systems.

1.10 Disinvestment

Disinvestment is the process by which a business or the government sells or otherwise divests its ownership of stock in a public firm. Disinvestment's main goals are to maximize resources, boost economic expansion, and raise public sector businesses' general effectiveness. Reducing the financial burden on either the government or the business is one of the main goals since it frees up resource which can be used in more beneficial ways.

Types of Disinvestment

1. **Minority Disinvestment:** This kind of disinvestment means that the government still owns more than 51% of the business. Consequently, management is in charge of the organization. Public sector enterprises are owned by citizens, thus the government aims to balance public interests with company policy. Typically, the government announces an OFS (Offer for Sale) to the public or holds an auction to attract possible investors for a minority ownership in the corporation.
2. **Majority Disinvestment:** In this kind of disinvestment, which the government gives up the majority stake but keeps the company's minority share of less than 50%. These decisions are made by the government using plans and policies. Occasionally, it combines the assets of two businesses to increase operational effectiveness.

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3. **Complete Disinvestment:** This kind of majority disinvestment transfers all of the company's ownership to the buyer, making the business a private entity.

Advantages of Disinvestment

1. Releases funds held by the government and reallocates them to sectors that are considered high social priority, such as family, welfare, and healthcare.
2. Reduces the national debt to alarming levels.
3. Increases the amount of limited resources left out to maintain the unprofitable public sector units.
4. Helps the commercial risk to be transferred to taxpayer funds that are trapped in public sector.
5. Releases labor and other resources for the social sector's best use.
6. Exposes the businesses to market rules and aids in their transition to independence.
7. Widens the distribution of wealth by providing private companies.
8. Boosts economic activity to allow for private investment in the public sector, which is advantageous for the economy, tax receipts, and employment overall.
9. Provides customers with higher-quality items and more options for shares, which also benefits employees and investors of small sizes.

Disadvantages of Disinvestment

1. Occasionally, too little money is raised by disinvestment, and the money that is released is not used as planned.
2. Disinvestment by profitable public sector entities might deprive the government of good returns.
3. Additionally, the disinvestment agency will not keep shares in PSUs following disinvestment if it wants to minimize commercial risks.
4. The labor force's scarcity does not impede the social sector's expansion.
5. To safeguard the public interest, the government must make sure that the market restrains and governs private enterprises.

6. The disinvestment program is unaffected by the shares' public sale. They had previously drawn few workers and benefited neither small investors nor workers.
7. Institutions own PSU shares that have been disinvested, with minimal floating stocks.

1.11 Strategic Alliance

A corporate agreement in which two or more organizations commit to providing resources or support for one another in order to accomplish a shared objective is known as a strategic alliance. Creating an alliance of strategic is a crucial step in reaching out to possible clients and partners. It can open up new doors for businesses, support their expansion, and add value for their clientele.

Types of Strategic Alliance

1. **Equity Strategic Alliance:** When one organization buys stock in another, giving it a portion of the business, an equity strategic partnership is created. Companies may buy one other's stock in specific circumstances to obtain a certain level of influence over their respective business activities. Through this kind of strategic alliance, a business can provide financial support by buying a share of the other company's equity and gaining control over a portion of the business's activities in exchange.
2. **Non-equity Strategic Alliance:** Ultimately, a non-equity strategic alliance is a collaboration in which the parties commit to pooling their resources and knowledge without creating a distinct joint venture or acquiring equity. Here, the partnerships are more loosely structured, with the participating companies benefiting from each other's ties.

Advantages of Strategic Alliance

1. **Enhanced Prospects for Sales and Marketing:** A corporation can increase sales and access new markets with the aid of a strategic alliance. Additionally, they can use it to create brand-new goods and services.

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2. **Increased Flexibility and Efficiency:** A strategic alliance enables a business to enter new markets and collaborate with a larger choice of partners. They can increase their efficiency and cut expenses by doing this.
3. **Enhanced Cash Flow and Earnings:** They can see an improvement in cash flow and earnings with a strategic alliance. Additionally, it can be used by a business to create new, profitable goods and services. Over time, this will result in them making more money.
4. **Enhanced Recognition of Brand:** Companies can improve consumer loyalty and brand awareness with the aid of a strategic alliance. They will find it simpler to sell goods and services in coming years as a result.

Disadvantages of Strategic Alliance

1. **Enhanced Competition:** When two businesses come together, the rivalry between them gets even fiercer. This could result in lower earnings since both businesses will have to put in more effort to keep ahead of the competition.
2. **Decreased Productivity:** When two businesses merge, the staff members may need to collaborate on initiatives that they were previously able to complete separately and share resources. As a result of forcing teams to collaborate rather than focus on their own separate initiatives, productivity may suffer.
3. **Increased Costs:** In certain cases, the businesses have to make investments in emerging technologies or other areas in order to function as a unified unit. Customers may pay more as a result of this, particularly if the alliance is unsuccessful.
4. **Identity Loss:** When two businesses combine, the brands and identities of both businesses often get combined as well. Customers may become confused as a result, and their loyalty may decline.
5. **Redundant Resources:** Businesses may find themselves in possession of an excessive number of unnecessary resources. This may lead to unnecessary expenses and decreased productivity within the company.

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1.12 Consolidation

A consolidation occurs when two or more companies merge to form one single organization. Businesses frequently transform into new entities with unique brand identities. There are many reasons why businesses want to combine, but the possibility of gaining more market share and long-term cost reductions is the most common one. Businesses can gain access to new markets and decrease operational inefficiencies by merging two or more organizations into one.

Advantages of Consolidation

1. Reduce expenses, increase income, and negotiate better terms with suppliers.
2. Simple to obtain (less expensive) funding.
3. Greater market share, range of products, geographic coverage, and clientele

Disadvantages of Consolidation

1. An increase in the amount of debt.
2. Workplace redundancies frequently result in layoffs and unemployment.
3. Variations in firm cultures.

1.13 Management Buyout

A management Buyout (MBO) is a phrase used to describe a financial transaction in which the business is acquired by a member of the team or corporate management from its owner(s). When management members carry out MBOs, they acquire every item related to the company. Professional managers are drawn to this kind of buyout because it gives them more control and more potential rewards than working as employees of the company.

MBOs are typically used to take businesses private in an attempt to increase profitability and streamline operations.

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A management group pools capital to buy all or a portion of a company they oversee.

Reason for Management Buyout

The corporate management may think about doing an MBO for the major reasons listed below.

Taking Charge: It's possible that management disagrees with the company's path. They might believe they have greater influence over the company's profitability and future by carrying out an MBO.

Financial Gain: It is possible for members of their management team to feel that their compensation for running the business is insufficient. They can profit by purchasing the business.

They Possess the Knowledge: The owner(s) may be perceived by management as lacking the skills and expertise necessary to guide the business.

Advantage of Management Buyout

Hedge funds and big financiers view management buyouts favorably as investment possibilities, and they typically push for the company to become private in order to increase profitability and streamline operations out of the public view. They have been encouraged to eventually go public at a substantially higher valuation.

If an MBO is supported by a private equity fund, it is probable that the fund will offer an affordable cost for the asset, given the presence of a committed management team.

Disadvantage of Management Buyout

The MBO structure has a number of disadvantages as well. Although the management group can benefit from ownership, they must shift their status from employees to the owners, which calls for a managerial to an entrepreneurial way of thinking. Not every manager will be able to make this change successfully.

In an MBO, the seller could not get the ideal selling price for the item for sale. If the current management group is serious about placing a bid for the assets or activities up for sale, then the managers may have a conflict of interest.

1.14 Leveraged Buyout

A leveraged buyout, or LBO, is an attempt by one business to acquire another by taking out a sizable loan to fund the deal. It is possible to utilize the assets of the company that was purchased as security against the acquiring company since bonds are issued against the combined wealth of the two businesses. Leveraged buyouts, often known as LBOs, are frequently used to spin off a section of an existing corporation by selling it or to turn a publicly traded company private. Additionally, they can be employed to transfer individual assets, such as ownership of a small corporation.

Advantages of Leveraged Buyout

An executed LBO might be advantageous to both the seller and the buyer.

Because they don't have to invest a large sum of money to purchase the target company, buyers value LBOs. The rate of return is positively impacted by this: Deals are sometimes very profitable because the company needs little down payment to move forward!

LBOs frequently result in the target company receiving good profits upon selling the company. They might receive less for the company when they were forced to accept an offer of cash in the absence of finance. However, financing can cover the difference between the seller's required investment and what the current price demands.

1.15 Buyback of Securities

Repurchasing shares, often known as buybacks, is a crucial restructuring tactic in which the firm buys back its own stocks from investors in order to either boost its value or remove any potential concerns from shareholders seeking to acquire a controlling position. Buybacks or share repurchases can benefit businesses in a number of ways. Repurchasing shares involves one-time cash returns. Companies might use their spare cash to buy back their shares instead of paying dividends. In addition, share buybacks can be implemented quickly, allowing for quick capital restructuring. On the other hand, it's possible that share repurchases could send the wrong signals to the market, leading it to believe that the company is not investing in any viable ventures.

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Objectives of Buyback of Securities

- To raise profits per share.
- To raise long-term shareholder value and increase return on capital and net worth.
- To give owners another way out when their shares are undervalued or scarcely traded.
- To improve the company's stake consolidation.
- To stop unwanted takeover offers.
- To give shareholders their excess cash back.
- In order to attain the best possible capital structure.
- To sustain the share price in times of weak market conditions.
- To more effectively serve the equity.

Methods for Buyback of Securities

The buyback permitted by subsection (1) might be:

(a) Proportionately from the current holders of securities; or

(b) From a public marketplace; or

(c) From strange lots, which are situations in which a public company's lot of securities whose shares have been listed on an established stock exchange is less than a marketable lot as the stock exchange may specify; or

(d) By acquiring the securities granted to staff members under their stock option or employee sweat equity program.

1.16 Summary

Corporate restructuring involves significant changes in a company's capital structure or activities to address financial instability. It encompasses financial and operational restructuring, such as acquisitions, mergers, divestitures, and strategic alliances. Mergers combine two or more companies to form a new entity, while demergers separate a business unit from the parent company. Joint ventures allow companies to pool resources for specific projects, often in international markets. Disinvestment reduces ownership by selling assets, and strategic alliances facilitate cooperation on shared business goals. Consolidation merges companies to improve market share and efficiency. Companies undergo restructuring due to strategic misalignment, lack of profits, reverse synergy, cash flow needs, global competition, sustainable growth goals, surplus cash, increased market power, and stagnation. These changes help businesses enhance performance, expand capacities, and maintain competitiveness in dynamic markets.

1.17 Answers to In-Text Questions

1. *(a)* Financial and Operational

2. *(c)* Major modifications related to business entities

1.18 Self-Assessment Questions

1. What is the difference between a merger and a consolidation?
2. How does Disinvestment help a company manage its financial resources effectively?
3. What are the different forms of demergers? How they differ from each other?
4. What do you understand by merger, consolidation and amalgamation?
5. Define and explain the Corporate Restructuring. What are the ten main forms of corporate restructuring?

1.19 Suggested Readings

- Weston, F., Chung, K. S., & Siu, J. A. (n.d.). Takeovers, Restructuring, and Corporate Governance. Pearson Education.
- Ramanujan, S. (1999). Mergers: The New Dimensions for Corporate Restructuring. McGraw Hill.

UNIT - II

L E S S O N

2

Merger & Acquisition

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STRUCTURE

2.1 *Learning Objectives*
2.2 *Introduction*
2.3 *Merger*
2.4 *Reasons for Merger*
2.5 *Acquisition*
2.6 *Reasons for Acquisition*
2.7 *Theories of Merger and Acquisition*
2.8 *Merger and Acquisition Process*
2.9 *Fast Track Merger*
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2.11 *Due Diligence*
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2.1 Learning Objectives

- Identify the primary reasons why companies pursue mergers and acquisitions.
- Learn and evaluate different theories that explain the motives and outcomes of M&A activities.
- Gain knowledge of the various stages involved in the M&A process.

2.2 Introduction

Companies use mergers and acquisitions, or M&A, as crucial strategic moves to boost growth, increase operational capacity, and become more competitive. Combining two or more businesses into one with the goal of maximizing synergies and producing value that exceeds the sum of its parts is known as a merger. Contrarily, acquisitions happen when one business buys out another, seizing control and frequently reorganizing the management and operations of the acquired business.

Mergers and acquisitions are motivated by a variety of factors, such as obtaining economies of scale, growing market share, breaking into new markets, obtaining new technologies, and enhancing financial performance. However, careful preparation, extensive due diligence, and efficient execution are essential to the success of M&A transactions. Theories of M&A offer frameworks for comprehending these deals, ranging from incentives based on efficiency to agency and theories of market power.

The target's identification, negotiation, investigation, screening, and integration phases are all included in the M&A process. Although cross-border M&As involve businesses from various countries and add additional complications such as cultural disparities and legal hurdles, fast track mergers speed this process and frequently occur within the same industry.

In M&As, there are a variety of ways to pay and finance a deal, such as cash transfers, stock swaps in general, or a mix of the two. Golden parachutes and poison pills are examples of defensive strategies against hostile takeovers that shield businesses against unwelcome acquisitions. M&As can be strategically beneficial, but they also often fail because of integration problems, cultural mismatches, and overvaluation. For this reason, meticulous preparation and execution are crucial.

2.3 Merger

A merger is the combination of two already-existing, independent businesses to create a single, new legal entity. The decision to merge is optional. Usually, both businesses are similar in size and scope, and they both stand to benefit from the deal.

A corporation may decide to merge in order to expand into a new market, offer a new service, or sell a new product. They can also modify pricing methods, enhance management, cut tax obligations, and lessen operating expenses. In the end, businesses merge to grow in size, scope, and income. Put another way, mergers increase corporate profits.

A merger is the union of two businesses that are around the same size. A merger is described as an agreement in which the assets of a number of companies are transferred to or placed under the management of one business, which might or might not be either of the original two businesses and which has all or almost all of its shareholders of the other two businesses as stockholders. It could also refer to the merging of several different businesses into one.

A merger could occur in any of the following scenarios:

1. A firm merges with B company, and two companies, A and B, decide to combine. The merging business is referred to as B Ltd.
2. A Company and B Company merge. The combined business is referred to as A Ltd.
3. Company C is the result of the merger of Companies A and B. The combined business is referred to as s C Ltd.

2.4 Reasons for Merger

The reasons for the merger are as follows.

1. **Synergy:** A circumstance in which the resulting company is worth greater than the whole of the merging firms' respective values is referred to as synergy. "Two plus two equals five" is the definition given. Advantages other than those associated with economies of scale are referred to as synergy. Another name for them is operating synergy. Synergy is the extra benefit that results from integrating

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the resources of two businesses in mergers and acquisitions. These benefits are especially likely to occur in horizontal mergers when the likelihood of removing duplicating facilities is higher. Mergers not only produce operational synergy, but also financial and management synergy. When a firm merges and acquires another with strong financial standing in return for shares, the combined company's financial restraints may be removed. In essence, mergers are a useful tool for ensuring consistent cash flow. Managerial synergy can also be achieved when a merger's senior management leverages their combined relevant experience to solve another company's difficulties.

2. **Strategic Change:** Combinations are employed, mostly in the form of technical innovation and regulatory framework modifications, to quickly respond to changes in the external environment. Deregulation brought about the removal of obstacles in the financial services industry. Commercial banks are expanding into investment banking, insurance, and mutual funds in addition to taking deposits and making loans. Innovation in technology gives rise to new markets, industries, and products. The usage of information technology is probably going to promote mergers, which are a quicker and less expensive way to get proprietary know-how and new technologies to close gaps in existing product offerings or launch whole new ventures.
3. **Strength of Global Competitiveness:** Indian corporations have a small size and a lower capability. Indian industries need to expand their capacity, introduce new technology, and cultivate export markets to remain competitive with Multi-National Corporations (MNCs). Labor costs are lowered and a large number of producing enterprises can access the marketplaces thanks to deregulation and globalization.

   Indian businesses have realized they must go global in order to survive. The greatest way to expand quickly in the global generic market and get a competitive edge internationally is through mergers and acquisitions.
4. **Diversification:** This refers to expansion via the joining of companies in unrelated industries. Conglomerate mergers refer to these kinds of mergers. Everyone wants to expand their business portfolios in

order to grow larger and faster because they believe that big is beautiful. Businesses took use of their core operations to generate the capital required to buy glitzy companies in more desirable sectors. As a result, a lot of companies grew into massive conglomerates that occasionally included hundreds of unconnected products and businesses.

5. **Market Penetration:** This refers to creating sizable new markets for an organization's current offerings. Markets that are growing increasingly international and global are typically those where market penetration strategies are implemented. One way to become or stay a prominent participant in these industries is through cross-border mergers. MNCs are the primary adopters of this method. They would much rather merge with a well-established local business that already has a clientele and understands market behavior in order to expand into new markets.

6. **Sustainable Growth:** A company's ability to enhance value, remain viable, and remain dynamic depends on its ability to grow. Growth could potentially result in increased earnings and value for shareholders. A business can expand into its current markets and/or enter new ones in order to meet its growth goal.

   Through acquisitions, a company might get external resources, including production facilities. Growth can be acquired more easily through mergers than by using a construction strategy. Purchasing a company that manufactures a product is a far easier option for a company looking to enhance production capacity than starting from scratch. Internal expansion takes time and necessitates operational infrastructure for things like production, research, and marketing. It takes time for internal growth facilities to mature.

IN-TEXT QUESTIONS

1. What is the primary objective of Synergy in a merger?

(a) It reduces operational cost

(b) It enhances managerial efficiency

(c) It increases combined value of the merging companies

(d) All of these

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2. What is a significant characteristic of a fast track merger?
   (a) Requires NCLT approval
   (b) Involves legal proceedings
   (c) Avoid public advertisements
   (d) Need extensive due diligence

2.5 Acquisition

There is no creation of a new company through an acquisition. Rather, the smaller business is frequently absorbed by the larger one, going out of business and having its assets integrated into it.

Compared to mergers, acquisitions—also known as takeovers—generally have a more negative connotation. Because of this, even though an acquisition is obviously a takeover, the acquiring company may refer to it as a merger. When one business assumes full responsibility for another's operational management choices, this is known as an acquisition. Large sums of money are needed for acquisitions, but the buyer has all the power.

Businesses may buy out another business to gain economies of scale—which drive down costs as output rises—by purchasing its supplier. Businesses may want to increase their market share, cut expenses, and launch new product lines.

When two distinct entities come together to form a single, new organization, this is known as a merger. On the other hand, an acquisition is the taking over of one company by another. Acquisitions and mergers can be carried out in an effort to increase a company's market share or achieve new heights for its shareholders.

2.6 Reasons for Acquisition

1. **Obtain New Technology or Knowledge:** Businesses that don't adapt to changing industries will not survive. For this reason, businesses are constantly searching for ways to purchase other businesses that can provide them with new technology and skills. We may anticipate that many of the large oil and gas companies will start investing in

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green energy companies, for example, as the energy transformation progresses over the next ten years.

2. **Scaling Economies:** Bigger tends to be preferable. That is the reasoning behind buying for the purpose of economies of scale. Bigger businesses typically benefit from cost reductions and competitive advantages which smaller businesses may not.
3. **Market Share:** Market share acquisitions tend to be on CEOs' minds since businesses are continuously assessing their position in relation to their competitors. This makes market share acquisitions possibly the most typical reason for M&A deals. Of course, one problem with this is that antitrust groups get upset when a company has an excessive amount of market share.
4. **Geographical Diversification:** Over the years, geographic diversity has been a major value-driver in M&A, and this makes sense. Instead of starting from beginning in a foreign nation, why not purchase an already-existing cash-generating corporation and utilize it as a springboard for the expansion of your own business there.

2.7 Theories of Merger and Acquisition

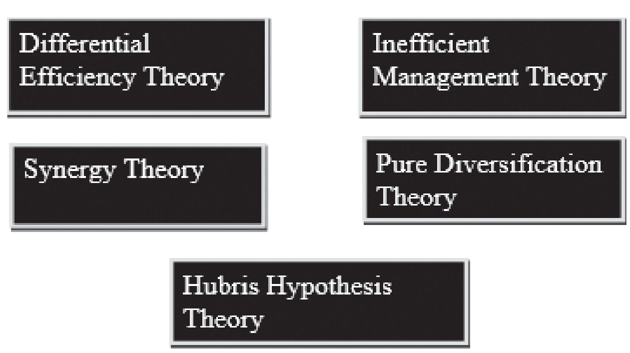

Figure 2.1: Theories of Merger and Acquisition

2.7.1 *Differential Efficiency Theory*

This theory states that if firm A acquires firm B and its management is more efficient than that of firm B, then firm B's efficiency will probably rise to the level of business A. According to the notion, certain businesses perform below par and have below-average efficiency as a result. These businesses are particularly susceptible to being acquired by more capable businesses operating in the same sector. This is due to the fact that more efficient businesses will be able to recognize businesses that have potential but are not as efficient.

2.7.2 *Inefficient Management Theory*

This idea is comparable to that of managerial efficiency, but it differs in that inefficient management refers to a company's management that isn't operating to its full capacity. The theory of inefficient management only depicts incompetence in its broadest definition.

2.7.3 *Synergy Theory*

The term "synergy" describes the kinds of reactions that take place when two materials or elements come together to create a bigger effect than the two taking separate actions could account for the capacity of the combination of two businesses to generate greater profits than either of the two businesses alone.

Synergy comes in two forms: financial synergy and operational synergy, collaborating in sync.

2.7.4 *Pure Diversification Theory*

There are several advantages to diversification for management, staff, business owners, and the company itself. Given that the company does not have the necessary internal resources or expertise, diversification through mergers is typically preferable to diversification by means of internal growth.

2.7.5 *Hubris Hypothesis Theory*

The Hubris Hypothesis suggests that managers search for business acquisition opportunities for their own possible reasons and that purchases are motivated by more than just financial gain. This notion becomes much clear when there is a competitive tender attempt to purchase a target.

The ironic theory that holds that the company that overestimates the target's value typically wins the competition is known as the "winners curse," and it frequently stems from the desire to win the game.

2.8 Merger and Acquisition Process

Following is the process of Merger and Acquisition

1. **Develop an Acquisition Strategy:** A successful acquisition strategy depends on the acquirer knowing exactly what they hope to achieve from the deal and why they are buying the business they are targeting (e.g., broaden product lines or get access to new markets)
2. **Establish the M&A Search Parameters:** Choose the most important parameters (such as profit margins, geographical location, or client base) that will help you find possible target companies.
3. **Look for Possible Acquisition Targets:** The acquirer searches for and assesses possible target companies using the search criteria they have chosen.
4. **Start the Acquisition Planning Process:** The buyer contacts one or more businesses that fit its search parameters and seem to be a suitable fit; the goal of the first discussions is to learn more and determine whether the target company is agreeable to a merger or acquisition.
5. **Conduct a Valuation Analysis:** The acquirer requests significant information from the target company (current financials, etc.) if the initial contact and negotiations go well. This will allow the acquirer to further assess the target, both as a stand-alone business and as a potential acquisition candidate.
6. **Negotiations:** The acquirer should have enough information to build a reasonable offer after creating multiple estimation models of the targeted company; following the presentation of the initial offer, the two businesses might further discuss the conditions.
7. **M&A due diligence:** Due diligence is a comprehensive process that starts as soon as the offer is accepted. Its goal is to verify or refute the acquirer's estimate of the target company's value by carefully examining and analyzing all facets of the target company's operations, including its financial measurements, assets and liabilities, clients, and human resources.

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8. **Contract for the Purchase and Selling of Goods:** Signing the final contract of sale is the next step, assuming that due diligence is finished without any significant issues or worries. The parties decide what kind of purchase agreement to use, such as an asset buy or a share purchase.
9. **Strategy for Financing the Acquisition:** Naturally, the acquirer has already looked into ways to finance for the deal; but, financial arrangements typically fall together when the purchase and agreement to sell is finalized.
10. **Acquisition Closure and Integration:** Following the acquisition agreement's closing, the management teams integrating the acquirer and the target collaborate to begin the process of combining their two businesses.

2.9 Fast Track Merger

On December 15, 2016, Section 233 of the Companies Act, 2013 and Rule 25 in the Companies (Arrangements, Amalgamations and Compromises) Rules, 2016 went into effect. It offers the idea of a streamlined merger. The fast track merger process is noteworthy because it avoids the need for judicial action, i.e., the National Company Law Tribunal's (NCLT) necessary approval. The Companies Act of 1956 required all mergers and restructurings to undergo drawn-out legal proceedings, with the High Court's participation being necessary. This made the process extremely expensive and time-consuming.

Acquisitions and mergers (M&A) will be a key determinant of the Indian economy's recovery from the COVID-19 pandemic. Considering the immense workload that IBC cases have placed on NCLT. A merger or amalgamation under the provisions of subsection 233 of the Companies Act of 2013 is the wise course of action.

This feature is quite advantageous for small and medium-sized businesses when it comes to of time, money, and convenience of use.

This is an even bigger potential for professionals such as company secretaries, who can advise their customers on organic growth and bring value to management.

Benefits of Fast Track Merger

1. NCLT approval is not necessary or requested.
2. No Public Advertisement Is Required.
3. No Meeting Called by the Court.
4. A reduced administrative workload.
5. It is possible to avoid hearing series.
6. The registration of the scheme will be interpreted as dissolving the transferor firms without requiring a winding-up procedure.
7. Relatively lower expenses and time savings.

Procedure of Fast Track Merger

- The merger between the Transferor and the Transferee Company must be approved by their respective articles of association. If not, they must amend their association's articles. The Object Clause of the Memorandum of Association among the two Companies shall govern the permissibility of the merger.
- Calling a board meeting to approve the plan.
- Notice of Submission Seeking Comments or Objections
- Submitting a statement of solvency
- Calling a General Membership Meeting or Class Meeting
- Calling a Meeting of Debtors or a Group of Debtors
- Submitting a copy of the plan and the meeting's outcomes to the regional director
- Scheme authorized from the Regional Director
- The transferor corporation will be presumed to have been dissolved by the
- Confirmation Orders filed in Form INC 28 without the need for a winding up procedure for the scheme of registration.

2.10 Cross-Border Merger and Acquisition

In both corporate and economic cycles, cross-border mergers and acquisitions are growing more and more common. Because of globalization, companies from several nations can now collaborate as a unified organization with the primary objective of advancing their corporate agenda on the international market. Businesses have been able to expand into other nations where it may have been extremely difficult to establish a business due to industry and logistical demands with ease thanks to mergers and acquisitions that take place across borders. However, in order to ensure that success will ultimately be realized and sustained over the course of the years of being present in this new market, a number of requirements must be properly satisfied. These demands are what make cross-border mergers and acquisitions successful.

If the goals of the participating companies are to be fully achieved, a number of success factors for cross-border mergers and acquisitions must be carefully taken into account. It stands to reason that the methods of doing business on each side of the boundaries where the acquisitions and mergers are to occur must differ.

Factors/Difficulties to be considered while Cross Border M&A

1. **Proper Management:** Cross-border mergers and acquisitions must be conducted with appropriate management procedures in all facets of the concerned business, just like any other business transaction. A few crucial areas of management that require careful attention to detail are product creation and integration, human resource management, and market analysis.

   Market study makes it clear that there are distinct markets, with primarily distinct demands and structures, on either side of the international boundary where such international mergers and acquisitions were to occur. Thus, it is imperative that the management strategies that are carried out include instructions on how to carry out a thorough market analysis prior to the commencement of the cross-border merger and acquisition activity.

2. **Culture Integration:** Cultural issues are never simple when it comes to international mergers and acquisitions. Cross-border mergers and acquisitions are typically very complex financial operations involving a wide range of cultural backgrounds. Among the parties engaged in a cross-border transaction, the phrase "culture" evokes varying interpretations. Most of the time, you'll find that certain

players on the opposite side on the border possess one perspective on the corporate culture, while other players on the other side have alternative perspectives. Those engaged may suffer grave consequences if they proceed with a cross-border merger and acquisition activity without completely integrating these divergent ideas on company culture.

3. **Business Policies:** Every nation has its own commercial regulations. These guidelines frequently specify how transactions are to be carried out in particular locations. The success or failure of a corporation in the markets that of these nations is determined by the policies. For example, businesses from various nations with differing business policies are active in cross-border mergers and acquisitions. Business A, which has always operated in a certain nation, may have mastered the art of adapting to its surroundings in the most effective manner in order to achieve its goals while adhering to the rules and regulations established there. This situation is likewise repeated for company B, which has operations in a particular nation.

4. **Taxation:** One of the greatest and most difficult problems in business is always taxation. The difficulties with taxes are exacerbated by international mergers and acquisitions. Because it operates within a foreign country, the acquiring company will often pay higher tax rates than its rivals in industries that are categorized as local enterprises.

   In cross-border mergers and acquisitions, the differing rates of taxation between the locally owned and foreign-owned businesses frequently hinder the goals of the acquiring company. Realizing sustainable profitability always becomes difficult as an unfair playing field regarding tax remittances to the officials of the country where the transaction is taking place develops.

5. **Overall Business Conditions of the Nation:** Most of the time, a variety of factors in the nations where the firm has been established will decide its success. It is important to fully address requirements like the assurance of security and the availability of dependable and practical insurance policies and plans. Given the substantial financial stakes in international mergers and acquisitions, it is imperative

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that these standards be met as soon as possible. In international mergers and acquisitions, delaying the provision of such beneficial pro-business terms could have severe consequences for the acquiring company. The substantial sums of money invested in the cross-border merger activity should always be guaranteed to be secure.

Advantages of Cross Border M&A

1. **Market Expansion:** With cross-border mergers and acquisitions, businesses can expand their clientele and reach new markets.
2. **Innovation Access:** Investing in international companies might provide access to cutting-edge methods, products, or technology that might not be available domestically.
3. **Resource Optimization:** Cross-border Mergers and Acquisitions (M&A) can result in improved capital, human, and physical resource utilization and management.
4. **Financial Gains:** Economies from scale, tax advantages, reduced operating expenses, and higher market share can all lead to financial gains via cross-border mergers and acquisitions.

2.11 Due Diligence

The act of gathering and evaluating information prior to making a choice is known as due diligence. Investors use this approach frequently to evaluate risk. It entails looking at a company's financial statements, comparing them over time, and measuring them against rivals in order to determine the growth potential of an investment.

The main goal of due diligence is to lower risk exposure. The procedure makes sure that before consenting to a transaction, a party is fully informed of all its terms. To ensure that the consumer is well-informed and is unable to hold the broker-dealer accountable for any losses, the broker-dealer, for instance, will provide the investor with the findings of the due diligence report.

Types of Due Diligence

When considering mergers and acquisitions, four main categories of due diligence usually come to mind:

1. **Financial due Diligence:** Financial due diligence include examining the company's past financial performance as well as making sure the figures in its financial statements are reliable and accurate.
2. **Legal Due Diligence:** Doing legal due diligence entails examining every legal facet of the business and its interactions with stakeholders. Licensing, regulatory matters, contracts, and any outstanding legal responsibilities are among the areas that are usually examined.
3. **Operational Due Diligence:** Operational due diligence is concentrating on how the business operates, i.e., how it converts inputs into outputs. This kind of due diligence is usually thought to be the most prospective.
4. **Tax Due Diligence:** Tax due diligence is keeping an eye on all of the business's tax-related matters and making sure that any outstanding payments are made on time and in full. Tax due diligence also considers the potential impact of a merger on the tax obligations of the newly formed firm.

Process of Due Diligence

1. **Examine the Project's Objectives:** Decide what you want to accomplish with the transaction. This can entail breaking into a new market, gaining new technology, or increasing your market share. Establishing specific goals guarantees alignment with your company's overarching strategy and aids in identifying the resources required.
2. **Examine the Financials of the Company:** Check the target company's financial records for accuracy and dependability. Examining financial statements, earnings statements, tax records, and debt schedules are all part of this process. This stage assists you in evaluating the performance, financial standing, and any possible warning signs of the company.
3. **Extensive Examination of Records:** Ask the target company for the relevant documentation, then interview the organization's important employees. This contributes to a better knowledge of the company's operations and helps confirm that its commercial practices adhere to industry and legal requirements.

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4. **Analysis of Models and Business Plans:** Examine the operational model and business plan of the target company to evaluate the model's viability and degree of alignment with your organization's objectives. This stage aids in your comprehension of the target company's sustainability and strategic fit.
5. **Formation of the Final Offering:** Compile all the data gathered to create a final appraisal. To decide the proposal you are going to present to the target company, use this valuation. To ensure an equitable and reasonable offer, multiple teams must work together in this step.
6. **Risk Assessment:** Determine and assess any possible hazards related to the purchase. This covers issues related to money, operations, and markets. You can make sure you're ready for any obstacles that may come up after the acquisition by practicing effective risk management.

These guidelines will help you carry out a comprehensive due diligence procedure and ensure that, before making an acquisition such as Tech Innovators, you make an informed choice. You may identify possible risks and rewards with the aid of this systematic strategy, which will ultimately result in a successful M&A deal.

2.12 Method of Payment and Financing Options in M&A

The methods of payment of mergers and acquisitions are the financial strategies used by the corporations to carry out the commercial transaction. The payment options for mergers and acquisitions consist of:

1. **Payment in Cash:** This payment method's ease of use and transparency make it popular in all business sectors. Businesses seem to find upfront cash payments to be more predictable and straightforward than other payment options. Even if cash is perhaps the most convenient method of payment, hefty transaction fees render it obsolete.
2. **Security Payment:** To buy the target companies' shares or assets, the purchasing firm creates new securities using a security payment mechanism. The following forms are present in it:
   (a) **Share Payment:** In order to buy the assets or stock of the target companies, the acquiring company issues fresh shares to

compensate for this payment. The most common of this type is the share exchange, which occurs when the target entity's stock and assets are bought by the buying business directly in shares.

(b) **Bond Payment:** In exchange for the assets and shares of the desired companies, the acquiring corporations issue a debt obligation with this payment. This type of bond has a very high credit rating and is negotiable as a payment option for mergers and acquisitions.

3. **Leveraged Buyout:** It describes a payment mechanism wherein purchasing businesses take on debt to finance capital through mergers and acquisitions. By using this strategy, purchasing firms undertake to take on more debt with the goal to raise finance from investors, using the target companies' predicted revenue from operations as security. They then pay cash to take over the target companies' ownership. Because loans from banks have significantly higher interest rates than cooperative bonds, leveraged buyouts have higher capital costs relative to bond payments.
4. **Debt Financing:** An excellent substitute for paying with cash or stock is to agree to assume the debt owed by the seller. Due to high interest rates and unfavorable market conditions, debt is often the driving force behind the sale of target enterprises.

   Under these conditions, the indebted company's first objective is to minimize the risk of more losses by engaging in a merger or acquisition with a business that will guarantee its debts.
5. **Earnout:** When a seller wishes to sell a business at a greater price and a buyer wants to purchase it at a lesser price, the seller frequently uses the earnout financing mechanism. Earnout functions as a sort of compromise in this situation.

   This earnout finance structure is based on the idea that only a portion of the deal price is paid in full upfront; the remaining amount is given as additional compensation at a later time, once the business meets predetermined metrics.

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2.13 Takeover Defence Strategies/Tactics

1. **Poison Pill:** A poison pill is a tactic used to try to prevent another company from making a takeover attempt by imposing new, unreasonable costs that need to be made after the takeover.

   Businesses have employed a variety of poison pill tactics to thwart hostile takeovers and corporate raiders. Giving present shareholders a preferred stock option, for instance, enables them to exercise their buy rights at a significant premium to the business, making the acquisition's cost suddenly unappealing. Taking on debt that would put the business in overleverage and maybe make it unprofitable is another strategy.

   Plans for employee stock ownership that vest only upon the completion of the takeover have been developed by several businesses. These employee benefits may cause an employee outflow from the company, leaving it without its brilliant team (which is frequently one of the motivations of the purchase), in addition to diluting the value of the stock.

   Giving business executives a set of golden parachutes is another example. This might potentially make the acquisition of the business unaffordable, as the buyer had intended to replace the senior leadership.
2. **Greenmail:** A strategy used in acquisitions called "greenmail" involves the acquirer paying a premium for the target's owners' shares in an effort to gain control over the target. Generally speaking, anti-greenmail clauses can only be adopted or removed by a company's shareholders through a vote.
3. **Golden Parachute:** An arrangement known as a "golden parachute" is made between an employer and an employee, typically a senior executive, that offers the employee substantial financial rewards in the event of termination. For instance, in the event of a management shuffle or ownership change, a golden parachute policy in an executive's

   An executive's employment contract may stipulate that, in the event of his departure from the company, he will get bonuses, stock options, special severance compensation, or other non-cash perks.

4. **Macaroni Defense:** Businesses use the macaroni defense through releasing bonds that may be redeemed for an elevated price in the case that power shifts. The bonds involved in macaroni defense grow in the presence of heat, just like pasta does in water. This can make the deal extremely difficult for prospective acquirers to swallow.
5. **White Knight:** A corporation that buys out a separate business that is attempting to prevent being acquired by a third party is known as a "white knight." Acquiring is done amicably by white knights. Because they are connected to virtue and righteousness, white knights are white. When a business is facing an aggressive takeover, the white knight steps in as its "savior". Company executives frequently look for a "white knight" to save the company's core operations, or just to reach better takeover terms.
6. **Pac-Man defense:** A tactic to prevent hostile takeovers is the Pac-Man defense. The Pac-Man defense is a severe measure since it frequently necessitates targets to take out loans or spend personal funds in order to buy possible acquirers.
7. **People Pill:** A protective tactic to prevent an adversarial takeover. The management team of the target company has threatened to resign as a group in the case of a takeover. A personnel pill is intended to deter the acquiring business from completing the transaction by raising the prospect of the need to assemble a whole new management team. This tactic only works if the purchasing business wants to retain the current leadership. Borden Corporation, a food firm, is credited with being the first to employ the people pills anti-takeover tactic.
8. **White Squire:** Highly comparable to a "white knight," except the squire buys a smaller stake in the target company as opposed to acquiring a controlling stake. Unlike a "white knight," a white squire does not need to have controlling interest in order to be regarded as a friendly acquirer.
9. **Sandbag:** The sandbag is a strategy used to conceal or lower expectations of a person's or company's strength with the objective to achieve better-than-expected outcomes. In the business world, sand bagging is most frequently observed when managers of the company lower

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guidance above what they already know will be accomplished in order to placate shareholders or superiors. The corporation appears even better after the results surpassing expectations are revealed.

2.14 Reasons for Failure in M&A

Two theories can be used to explain a failed merger or Acquisition: First, from a qualitative standpoint, the original goals that drove the companies to join ultimately don't work out that way. Second, because operating performance worsens rather than improves, stockholders lose out quantitatively.

The results of past scientific investigations and consultant reports make it abundantly evident that mergers and acquisitions frequently fail. As such, they were unable to generate money or value for the acquisition company's stockholders. There are many reasons why mergers fail, hence it is impossible to pinpoint one specific reason why they don't create value for the acquiring shareholders.

The following can act as reasons for failure:

1. **Lack of Research:** Acquiring a target involves obtaining a great deal of knowledge about its capabilities, finances, management, and tangible and intangible assets. In all of these areas, a great deal of research is needed. Negligently conducted due diligence on the purchase results in the depletion of the acquirer's wealth and the failure of the merger.
2. **Role of Media:** Remarks from journalists and other professionals in various media outlets may also be a part of why these opportunities seem so alluring. A merger or purchase that is deemed successful by analysts in a reputable financial paper, for example, is likely to be exalted. Undoubtedly, many businesses find this intriguing, and they might view a comparable course of action as a means of achieving comparable success. Most people agree that most businesses fail at this time.
3. **The Hubris Attitude**: Sometimes, a purchase or merger could be carried out with the intention of "seeking glory," as opposed to considering it as a business strategy to meet the goals of the organization. Whatever the objective of the company, the top executives are more eager to appease their "executive ego."

Without a doubt, size plays a key role in corporate success. Consequently, managers whose income is highly influenced by size have a strong inclination to create large empires.

4. **Inappropriate Organization Fit:** Acquirers frequently neglect to adequately plan and carry out the combination of their targets, which contributes to merger failure. The managerial and internal cultural aspects are often overlooked by many businesses, and insufficient understanding of the target's operations should be fixed during the due diligence process. But is far too frequently disregarded. But lots of businesses have a good track record of acquisitions. Their targets are well chosen, they almost never participate in competitive auctions, and they frequently have the discernment to back out of agreements when they acknowledge the seriousness of the anticipated integration issues, and after purchases are closed, they appear to be able to integrate acquisitions fast and effectively. The inability of an organization to fit together causes mergers to fail.
5. **Mismatch in Size:** One of the factors contributing to subpar acquisition performance is a mismatch in size between the acquirer and the target. An alliance between two powerful businesses is a better option than one between two inexperienced ones. While weak companies search for larger corporations to save them, many big companies look for little partners in order to seize control. Many purchases fall victim to "acquisition indigestion," which occurs when large targets are purchased too quickly or when smaller acquisitions are not given the necessary time and care. Furthermore, the proportion of gains to the acquirer will be far lower than the proportion of gains to the target enterprises when the acquirer is extremely large in size.

   Past experiences indicate that a weak connection can become a hindrance and lead to conflict in a partnership.
6. **Diversification:** Very few companies are able to handle a variety of businesses with success. Diversification that is unrelated has been linked to poorer financial performance, lower capital productivity, and a higher degree of performance variance for a number of reasons, such as a lack of concentration, a perceived inability to create significant synergies, or a lack of manufacturing or geographic

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knowledge. Acquisitions that seem unrelated at first glance could end up being a huge letdown in the end.

7. **Previous Acquisition Experience:** Many failed acquirers typically have minimal prior acquisition experience, even though it's not always a prerequisite for future acquisition success. Acquirers with prior experience will be better equipped for making successful acquisitions in the future by learning from their failures. Serial acquirers are more inclined to make successful acquisitions if they have an implementation team that is skilled and knowledgeable and if they have the internal competencies required to support acquisition success.
8. **Poor Strategic Fit:** Only when there is a strategic fit among the merging companies will a merger produce the intended outcome. Strategically aligned mergers can increase profitability by cutting costs, making better use of existing infrastructure, raising capital more affordable, and allocating excess capital to higher-yielding business ventures. However, a lack of synergies and/or a lack of a strategic fit between the merging companies frequently leads to merger failure. The business philosophy of the two entities (the amount of return investment return vs. share of the market), the timeline for accomplishing these objectives (short-term vs. long-term), and the manner in which assets are used are other factors that can contribute to a strategic fit.
9. **Lack of Immediate Integration:** Bringing the target and the acquiring business together on all fronts is a crucial responsibility in mergers. It is necessary to set up all departments, including marketing, finance, production, design, and human resources. Key individuals from the purchased company should be maintained and given enough prominent opportunities inside the merged organization, in addition to the notable members of the acquiring company. It is important to keep the beneficial elements of past cultures while removing the unnecessary ones. A delay in integration causes the business's road map to slow down and causes delays in product development and shipment.
10. **Lack of Instant Integration:** One of the most important tasks in mergers is integrating the target organization and the acquiring company completely. All departments, including those for finance, marketing, manufacturing, design, and human resources, must be

established. Along with the significant employees of the acquiring company, key personnel from the company that was bought should be retained and given ample visible opportunities inside the combined organization. It's critical to preserve historical cultures' positive aspects while eliminating their superfluous ones. Development of products and shipment are delayed as well as the company's road map when there is a delay in integration.

2.15 Summary

Acquisitions and mergers, or M&A, are essential tactics used by businesses to improve their competitive edge and spur expansion. When two or more businesses merge, they become a single, new organization that can take advantage of synergies including increased market penetration, lower costs, and a stronger competitive edge. When a business acquires another, it frequently restructures its operations to better meet its strategic objectives.

There are several justifications for seeking M&A. Organizations may pursue economies of scale, heightened market penetration, forays into untapped areas, procurement of novel technologies, or enhancement of their financial outcomes. Market power theory, agency theory, and efficiency theory are a few examples of theoretical frameworks that shed light on the purposes and anticipated results of M&A transactions.

In M&A payment and financing techniques can take several forms, such as stock swaps, all-cash transactions, or a combination of both. Every approach has effects on the participating companies' risk distribution and financial structure. Poison pills, golden parachutes, and other defensive strategies against hostile takeovers enable businesses to keep control and bargain for better terms.

Many M&A fail without the potential for significant gains because of things like culture mismatches, integration issues, and target business overvaluation. These mistakes show how crucial careful preparation, in-depth investigation, and efficient post-merger integration techniques are to achieving the intended results. Leveraging M&A deals for generating long-term value requires an understanding of the strategic imperatives and complexities involved.

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2.16 Answers to In-Text Questions

1. *(c)* It increases combined value of the merging companies

2. *(c)* Avoid public advertisements

2.17 Self-Assessment Questions

1. Evaluate the Fast Track Merger Process under the Companies Act, 2013.
2. Examine the Impact of Cross-Border Mergers on Global Competitiveness.
3. Critically evaluate the theories of Mergers and Acquisitions.

2.18 Suggested Readings

- Gupta, M. (2010). Contemporary Issues in Mergers and Acquisitions. Himalaya Publishing.
- Sundarsanam (2006). Creating Value from Mergers and Acquisitions (1st ed.). Pearson.
- Ramanujan, S. (1999). Mergers: The New Dimensions for Corporate Restructuring. McGraw Hill.

UNIT - III

LESSON

3

Deal Valuation & Evaluation

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STRUCTURE

3.1 *Learning Objectives*
3.2 *Introduction*
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3.6 *Economic Value Added*
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3.1 Learning Objectives

- Understand and apply various business valuation methods, including DCF, EVA, and Sensitivity Analysis.

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- Evaluate the financial implications of business decisions using cost-benefit analysis.
- Determine the value of synergies in mergers and acquisitions.
- Calculate the swap ratio and understand its significance in mergers.

3.2 Introduction

Business valuation is a critical process in finance, aimed at determining the economic value of an entire business or company unit. Various methods are employed to ascertain this value, each with its unique approach and focus. The Discounted Cash Flow (DCF) approach estimates future cash flows and discounts them to present value, reflecting the company's profitability. Economic Value Added (EVA) measures a company's financial performance based on residual wealth. Sensitivity Analysis evaluates how different variables impact a business's value. The valuation of slump sales involves assessing the entire business sold as a going concern. Synergies' valuation in mergers and acquisitions quantifies the potential financial benefits derived from combining entities. Cost-benefit analysis weighs the financial pros and cons of business decisions. The swap ratio, essential in mergers, determines the proportion of shares exchanged between companies. Understanding these concepts is vital for financial professionals to make informed decisions and provide accurate valuations.

3.3 Business Valuation

The process of ascertaining a business's economic value is called a business valuation, sometimes referred to as a company valuation. In the procedure of valuation, all parts of a firm are assessed to establish its worth including the market value of its divisions or units.

The true market value of an operation can be ascertained through a company valuation for a number of purposes, such as taxation, divorce proceedings, partner ownership establishment, and sale value. When seeking an unbiased assessment of the worth of their company, owners frequently seek the services of qualified business evaluators.

In corporate finance, the subject of business valuation represents a topic that is often discussed. Business valuation is usually carried out when a firm wants to merge with another business or buy another one, or when it wants to sell all or part of its activities. The process of estimating a company's present value by assessing all facets of the enterprise and applying objective metrics is known as business valuation.

An examination of the management team, the financial structure, the company's potential for future profits, and the asset market value are all possible components of a business appraisal. The instruments employed in valuation can differ among assessors, companies, and sectors. Examining financial accounts, discounting cash flow models, and comparing similar companies are common methods used in business valuation.

Tax reporting also requires accurate valuation. Businesses must be valued according to their fair market worth, as mandated by the Internal Revenue Service (IRS). Depending on valuation, certain tax-related actions, like the sale, purchase, or donation of company shares, may be subject to taxes.

Reasons to Find Valuation of Business

Since valuation can be used to find mispriced securities or identify initiatives in which a corporation should invest, it is a crucial exercise. Below is a list of some of the primary justifications for conducting a valuation.

1. **Purchasing or Disposing of a Business:** The worth of a firm will typically change between buyers and sellers. A valuation would be helpful to both parties when deciding whether or not to buy or sell, as well as to sell at what price.
2. **Strategic Planning:** Investments in initiatives that raise a company's net present value should only be made. As a result, every investment choice is really a mini-evaluation predicated on the possibility of future wealth generation and profitability.
3. **Funding for Capital Projects:** In negotiating with the bankers any other possible investors for finance, an objective appraisal might be helpful. Demonstrating proof of a business's value and cash flow generation capabilities makes it more credible to equity investors and lenders.
4. **Investing in Securities:** Purchasing some security, such as stock or bond, is simply a wager that the security's market value isn't being accurately reflected. Understanding that intrinsic value requires a valuation.

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3.4 Methods of Valuation

There are several methods for valuing a business. Below, you will discover more about a few of these techniques.

1. **The Amount of Market Capitalization:** The most basic approach to corporate valuation is market capitalization. It is computed by multiplying the share price of the business by the total number of outstanding shares.
2. **Time Revenue Method:** A stream of revenues earned over a predetermined period time frame is converted to a multiplier, which is dependent on the sector's and economic environment, under the current revenue business valuation approach.
3. **Profit-Multiplier:** Since a company's profits are a more dependable predictor of its financial performance than sales revenue, the earnings multiplier can be used to determine a company's true value rather than the times revenue method. The earnings multiplier compares projected profits to cash flow that may be invested over the same time period at the present rate of interest. Stated differently, it modifies the existing P/E ratio to reflect current interest rates.
4. **The Method of Discounted Cash Flow (DCF):** The earnings multiplier and the DCF approach of business valuation are comparable. This approach is predicated on estimates for future cash flow that are then modified to determine the company's present market value. This discounted cash flow approach and the earnings multiplier method vary primarily in that the former uses inflation into account when determining present value.
5. **Book Value:** This is the overall balance sheet statement value of a company's shareholders' equity. A company's book value is calculated by deducting all of its liabilities from all of its assets.
6. **Value of Liquidation:** The total amount of money that a company would get if its liabilities were settled today and its assets were sold off is known as its liquidation value.

The business valuation techniques that are now in use are by no means all included in this list. Replacement worth, breakup value, asset-based appraisal, and numerous other techniques are other approaches.

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IN-TEXT QUESTIONS

1. Which valuation method focuses on projecting and discounting future cash flows to their present value?
   (a) Economic Value Added
   (b) Sensitivity Analysis
   (c) Discounted Cash Flow
   (d) Cost – Benefit Analysis
2. What does the swap ratio determine in context of a Merger?
   (a) The total earnings per share
   (b) The percentage of shares that are traded between the merging businesses
   (c) The importance of synergy
   (d) Residual wealth of company

3.5 Discounted Cash Flow Approach

A valuation estimation that's frequently computed during an M&A's due diligence phase is the Discounted Cash Flow (DCF). By allowing them to evaluate various transactions and assess if a capital investment and M&A transaction is right for them, it aids firms in understanding the current value of a possible investment. When used appropriately, this cash flow strategy can give prospective purchasers insight into the present worth and expected cash return of an investment or firm. However, it does require a lot of facts.

By discounting projected or anticipated future cash flows, this analytical technique can be utilized to determine the investment's worth. The DCF analysis's objective is to determine an investment's current value by estimating the future cash flow it will provide. The DCF analysis is frequently employed in mergers and acquisitions as well as inorganic growth plans. It can be applied to investments in stocks, securities, projects, assets, or companies.

The best technique to determine the value of an investment is to perform a DCF analysis. In order to determine a company's current worth, the

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cash flow approach projects its future earnings and discounted them to the present. Prospective purchasers are able to better understand a company's current market value with the aid of these cash flow models. To put it succinctly, DCF is the total of all projected potential discounted cash flows from an investment. "CF" stands for the cash flow for a specific year, and "r" is the decimal discount rate applied to the target investment.

The DCF formula might change depending on the kind of investment being examined and the financial data that is available. While there are other formulas available to businesses using DCF analysis, it is the most commonly used and simplified one. All DCF models, however, call for a substantial quantity of data and specifics, together with all key investment assumptions and anticipated future returns on investment or business.

How Does a Discounted Cash Flow Method Help Businesses?

Businesses can use the DCF method to calculate the return on an investment. To perform a DCF analysis, potential purchasers need to take into account the following:

The after-tax net income.

Assumptions on a range of variables on the anticipated growth in sales and profit margins of a business.

The initial investment's interest rate.

The capital cost.

Every possible hazards that an organization might encounter.

As mentioned before, a substantial quantity of information about the business and investment is needed for the DCF model. The DCF analysis process becomes easier with increased financial data and understanding of the organization. In the process of making decisions, analysis is essential.

What use does a DCF have in Mergers and Acquisitions Transaction?

The DCF technique, which calculates the company's worth by calculating the present flow of cash over the course of the company's life, is frequently used during the course of the process of due diligence in corporate M&As. The terminal value and the projected period make up the two components of the DCF analysis. The terminal value of the corporation is the value determined from the free cash flow after the forecast period, whereas the period of forecasting is when the firm surpasses needed returns. The acquirer in an M&A transaction will be better equipped to decide whether to submit a bid, engage in negotiations, or let go of the target company if they have a clear understanding of the company valuation.

Companies that use M&A end up with inorganic growth corporate strategy. There are two types of valuation associated with an inorganic growth strategy: income-based and market-based. To ascertain a value according to projected future revenue or earnings, income-based assessment is more frequently employed.

Advantages of Discounted Cash Flow

The following are some of a DCF's primary benefits:

As it makes use of precise figures for cash flow estimates, growth rate, interest, and other metrics, the DCF analysis is quite thorough.

It takes into account long-term values by evaluating an investment's returns over the course of its life value.

It makes it possible to compare various businesses or investments in order to determine a fair price for them.

It helps business executives decide whether to merge with or buy another business in an M&A deal.

Disadvantages of Discounted Cash Flow

The following are a DCF's primary drawbacks:

A large amount of knowledge and financial information, including estimates for income and capital expenses over a number of years, are needed to do a DCF analysis. It may take a long time to collect all the data.

An accurate analysis requires precise estimates.

As so much information is required to compute the analysis, it can become extremely complex.

Since the study is predicated on cash flow estimates for the future, it may lead to overconfidence.

3.6 Economic Value Added

Economic Value Added, often referred to as Economic Profit, is a metric that gauges return over and beyond investors' needed rate of return (obstacle rate), and it is based upon the Residual Income approach.

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EVA is a measure of a project's profitability that a business invests in. Its fundamental assumptions are that: (1) projects should produce returns greater than their cost of capital; and (2) real profitability happens when new wealth emerges for investors.

After deducting a finance charge from net operating profit, EVA is determined. The necessary rate of return for the company's capital investment is captured by the finance charge.

If a company's EVA is positive, it indicates value addition; if it is negative, value it is destruction.

Economic Value Added formula:

EVA = NOPAT – (WACC * Capital Invested)

EVA = Economic Value Added

NOPAT = Net Operating Profit after Tax

WACC = Weighted Average Cost of Capital

*Finance charge is (WACC * Capital Invested)

Ques: Madhuri Ltd. has invested capital Rs. 220 crores in assets. The operating income after tax is Rs. 50 crores & Company's cost of capital is 15%. Find out EVA.

Solution: Here, Capital Invested = 220 crores

NOPAT = 50 crores

WACC = 15%

EVA = NOPAT – (WACC * Capital Invested)

EVA = 50 – (15% * 150)

EVA = 50 – 22.5

EVA = 27.5 crores

3.7 Sensitivity Analysis

Sensitivity analysis is an approach employed in financial planning to examine the effects of varying independent variable values on a given dependent variable under particular circumstances. Sensitivity analysis is often applied across many disciplines, from economics and engineering to geography and biology.

When studying and analyzing “Black Box Processes,” in which the result is an ill-defined function of multiple inputs, it is quite helpful. A process or function that defies analysis and study is said to be opaque. In geography, for instance, climate models are typically extremely intricate. As a result, it is unclear exactly how the inputs and results relate to one another.

It is important to understand how the model is affected by changes in growth and Return on Invested Capital (ROIC). We first performed a sensitivity analysis on growth, EBITA margin, capital turnover, and WACC. The following table summarizes the results:

	Base Value 1999-2003 (Percent)	Change (Percent)	Change in Equity Value	
			(NLG Billion)	(Percent)
Revenue growth	5.6	1.0	3.3	9.8
EBITA margin	11.1	1.0	3.8	11.4
Capital turnover	2.4	0.1	2.4	7.2
WACC	6.7	-0.5	7.5	22.5

We see that aside from changing WACC, a change in EBITA margin and growth has greater relative impact on the equity value of Heineken than capital turnover. The impact of WACC on the model is especially curious given the current capital structure; it seems that taking on debt can create the greatest value.

The result of the sensitivity analysis is not surprising. Given the already relatively high return on invested capital (above 10 percent), Heineken’s best bet would be to increase its growth rate.

3.8 Valuation of Slump Sale

A slump sale is when all of the company’s assets and liabilities are sold for a single amount rather than having each asset’s worth determined as a lump sum amount. This can apply to the sale of a business unit or the full undertaking. In order to calculate capital gains tax, net assets must be transferred at book values, according to Section 50B in the Income

Tax Act. There was no need to calculate fair value because the actual consideration was accepted in Full Value Consideration (FVC) under capital gains tax purposes. The application on section 50B of the exchange in relation to the duration of holding the undertaking was unclear.

Section 50B of the Finance Act of 2021 has been revised to clarify that the phrase "slump sale" includes transfers made through any means and that the Fair Market Value, or FMV, on the transfer date would be regarded as FVC. In order to calculate capital asset fair value (FMV) for section 50B in the Income Tax Act of 1961, CBDT notified Rule 11UAE. Section 50B(2) of the 1961 Income Tax Act has been replaced by Article 21 in the Finance Act, 2021, which states as follows:

(i) In this the objectives of sections 48 and 49, the "net worth" of the undertaking and the division, as applicable, will be considered to be the price of acquisition as well as the cost of improvement, and the provisions provided for in the second subsection to section 48 shall not be taken into consideration;

(ii) The complete amount of the compensation received and accruing as a consequence of the sale of such capital asset shall be assumed to be the actual market value of the property in question as upon the occasion of transfer, computed in the prescribed way;

There are two ways to calculate the Fair Market Value (FMV) of the net assets, according to Notification Number. 68/201-Income Tax, dated May 24, 2021. The slump sale date will serve as the valuation date, with the net asset's FMV being the higher of the two.

Technique 1: All assets—aside from jewelry, artwork, shares, equities, and real estate—will be sold using this technique at the value of their book value. Stamp duty value with respect to the immovable property will serve as the FVC. The FMV of jewelry and creative work (which may be sold on the open marketplace) will be based on a valuation report from a registered valuers, shares, and securities according to Rule 11UA(1) in the IT Rules.

Technique 2: This approach would comprise cash received or accruing upon transfer, FMV of non-cash received or accruing upon transfer reflected in property (as specified and in accordance with Rule 11UA(1) in the IT regulations), The stamp duty amounting to non-monetary account received or accruing upon transfer represented by immovable property (not mentioned in Rule 11UA(1) within the IT Rules) is equal to the readily available market price (which is based on a valuation report obtained by a registered valuer) for non-monetary account received or accruing upon transfer referred to by the property, apart from immovable property.

3.9 Valuation of Synergies

Synergy is the extra value that results from the merger of two businesses. It is the increased value that results from the companies pooling their resources together, which would not be possible for them to do alone. This extra value may come from lower expenses, more income, or both. By increasing sales and/or cutting costs above and beyond what each firm could accomplish on its own, synergy adds value to mergers.

The technique of estimating the value of the synergy produced by the merging of two businesses is known as "synergy valuation." Through this procedure, present-day value of all potential synergistic advantages is estimated and added to the current valuation of the company.

Types of Synergies: Synergies between revenue and costs are essential for increasing the worth of acquisitions and mergers.

(i) **Revenue Synergies:** Businesses can access new markets and goods to create revenue synergies that allow them to access new client bases and income streams. Businesses that combine can access each other's previously inaccessible markets. By making use of a shared distribution network, they may reach a wider audience. Additionally, a diversified product line creates chances for cross- and up-selling, which boosts market share. The 2014 merger of Lafarge and Holcim serves as an illustration of this, as it gave the new company:

The most extensive selection of construction materials, cement, and aggregates available worldwide,

The broadest and most varied geographic coverage,

A better position to take advantage of chances for expansion in new markets and recovery of established markets, as well as the capacity to support special innovation skills for creating novel and sustainable goods and solutions.

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(ii) **Cost Synergies Between the Balance Sheet and Income Statement:** Statement of Income Synergies: Financial synergies like reduced interest rates and tax synergies, such as the ability to offset losses or lower the total tax rate, enhance the financial condition of the merged entity. Synergies can be noticed in several areas, such as reductions in the cost of goods, sold and marketing, general and administrative expense, and streamlined operational expenses. The combined firm experiences immediate cost reductions as a result of these synergies.

Balance Sheet Synergies: In addition to the income statement, the balance sheet synergies also involve operating liquidity and capital expenditure efficiencies, which bolster the merger's financial and strategic benefits. Notably, these synergies lead to improved capital efficiency even if they might not immediately cut expenses.

(iii) **Financial Synergies:** Financial synergies are advantages that might arise from combining two businesses by making the merged company's finances and capital structure as efficient as possible.

Financial synergies can be obtained through offering tax benefits, utilizing tax losses or credit from one firm to offset the profits of another, and increasing one's debt capacity through increased scale, diversification, and consistent cash flows.

To put it briefly, economies of scale can enable a more effective client acquisition strategy along with more favorable unit pricing (i.e., larger profit margin per sale), while a stronger reputation profile and easier access to financing may reduce the cost of capital.

The goal of financial synergies is to lower the cost of capital for the combined company and raise its financial flexibility relative to the separate businesses.

Question: A merger between Companies P and Q is being considered. The following is pertinent financial data for both companies:

Company P:

500 is the market value.

There are 25 outstanding shares.

Profits: 40

Company Q:

300 is the market value.

There are 15 outstanding shares.

Profits: 20

Due to cost reductions and enhanced revenue potential, the combination is anticipated to yield synergies valued at 50.

(a) Determine the post-merger overall value of the merged company, taking synergy value into account.

(b) Find the combined company's new Earnings Per Share (EPS).

(c) If the pre-synergy value between Company P with Company Q is the basis for the purchase price, then calculate the amount of premium you paid for Company Q.

Solution:

(a) **Overall value of the merged company**

Total Value = Market Value of Company P + Market Value of Company Q + Synergy Value = 500 + 300 + 50 = 850

(b) **New earnings per share**

Combined Earnings = Earnings of Company P + earnings of Company Q = 40 +20 = 60

Total Shares Outstanding = Shares of Company P = Shares of Company Q = 25 +15 = 40

Combined EPS = Combined Earnings/Total Shares Outstanding = 60/40 = 1.50

(c) **Amount of premium**

Pre-Synergy Total Value = Market Value of Company P + Market Value of Company Q = 500 + 300 = 800

Pre-Synergy Value per Share = Pre-Synergy Total Value/ Total Shares Outstanding = 800/40 = 20

The purchase price for Company P is based on the pre-synergy value per share of the combined company:

Purchase Price for Company P = Pre-Synergy Value per Share × Shares of Company Q = 20 ×15 = 300

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Since the market value of Company Q is 300, the premium paid is:

Premium Paid = Purchase Price for Company Q−Market Value of Company Q = 300 − 300 = 0

3.10 Cost Benefit Analysis

A methodical technique for evaluating the benefits and drawbacks of options that meet a company's needs for operations, transactions, or functional requirements is called cost-benefit analysis, or CBA. It serves as an analytical tool for weighing the benefits and drawbacks of an initiative or choice in order to assess its viability.

Direct costs that are simple to measure include labor, material, and equipment expenditures. These are known as tangible costs. Benefits that can be measured in money, including revenue, savings, and return on investment, are referred to as tangible benefits.

Intangible costs, such as missed opportunities and lost productivity, are indirect expenses and possible hazards that are more difficult to measure. Non-financial gains like higher staff morale or better customer satisfaction are examples of intangible benefits.

Whenever decisions are made, trade-offs are inevitably involved. Determining if the advantages of a specific course of action outweigh the associated trade-offs is the main goal of a cost-benefit analysis. It assists organizations in assessing if a decision is in line with their aims and objectives and how it might affect their resources.

Purpose of Cost-benefit Analysis: A cost-benefit analysis's straightforward goal is to identify solutions that offer the most efficient means of attaining company objectives while maintaining cost reductions. It assists corporate executives in reaching important decisions by weighing the possible advantages and disadvantages of every option. It also aids in the identification of any unanticipated repercussions that can result from a choice.

A cost-benefit analysis's conclusions provide management and executive teams with crucial information, such as:

Is a project financially feasible?

How much money should be set aside for the project?

Setting priorities for projects and allocating resources.

The project's anticipated return on investment, or ROI.

Which projects would thus be given less priority?

The potential effects of the initiative on its clients or staff.

Possible dangers and difficulties related to the project.

A cost-benefit analysis gives decision-making a structured method, which helps organizations defend their decisions and effectively inform stakeholders about them. Although it is subjective, it makes well-informed conclusions based on objective evidence. It thus lessens decision-making bias and motivates businesses to make well-informed decisions.

Cost-benefit Analysis in Merger and Acquisition: Among the most well considered and organized undertakings in a company's lifespan are M&A transactions. They usually take up to six months or more years to complete and demand a large amount of time, money, and careful thought.

Typical components of cost-benefit analysis for M&A are:

The sum paid to acquire the other business

Integration expenses (people, systems, and culture)

Potential for market expansion following the acquisition

Possible synergies or cost savings advantages in the marketplace that the acquisition gives the acquiring organization.

The probability of the transaction closing (due diligence)

Businesses do a CBA as well when deciding whether to sell off particular business segments. They assess if the lines are performing so poorly that selling them would be a better long-term investment than holding onto and improving them.

Process in Cost-benefit Analysis

Although the precise processes may differ significantly based on the source and context, a widely recognized cost-benefit analysis framework consists of the following seven steps:

1. **Specify the Goals and Extent:** The issue you wish to address or the chance you want to assess is your "scope." The things you intend to achieve by resolving that issue or seizing that chance are your "objectives."

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This initial stage presupposes that you have previously recognized an issue or possibility and are weighing your options for a solution. This step will involve regarding identifying the market potential and your ideal consumer profile if you're seeking to generate fresh product concepts.

2. **Explain All of the Possibilities:** When the time comes to taking advantage of an opportunity or fixing an issue, there are usually multiple options available. After you've determined your goals, think about every possible avenue to achieve them.

   Apart from changing CRMs, you might also:

   Use technology for sales automation.

   Employ an alternative sales framework to shorten the duration of the deal cycle.

   Purchase various marketing materials.

   Introduce new features and products.

   Lower/higher prices

   Recruit or fire more salesmen

   Firm should also think about the possible outcomes of maintaining the status quo. You may choose that a certain activity, such as switching CRMs, isn't worth the accompanying expenses and effort, or you may choose to do nothing at all.

   List all appropriate solutions or substitutes that could help achieve the stated goals. Think about a variety of possibilities, such as maintaining the status quo as well taking no action.

3. **Mention Expenses and Advantages:** Every one of your options will have advantages and disadvantages of their own. This is where you assess which growth initiatives are now the most feasible for your business, as you are likely considering investing in many ones at once.

   To do so, you'll need:

   Pertinent measurements

   Employee opinions

   Client opinions

   Assessments of trends

Figures of cost for tools, infrastructure, and software

Time and personnel cost estimates

Market information

4. **Make the most of Your Expenses and Gains:** There will be clear financial ramifications for some of these expenses and gains. For instance, it's easy to estimate the cost of setting up software (a sales representative will handle it).

   However, you must account for the expenses of:

   Not addressing the problem

   Not everything is going as planned

   Potential return on investment when choosing between initiatives Long-term client satisfaction and attrition

   Value of each saved or enhanced bargain over time

   The initiative's long-term scalability and income potential

   The majority of expenses have a direct—and frequently undetected—impact on the expansion of businesses. When evaluating various issues where the financial ramifications are not immediately apparent, forecasting models can be used to assist you weigh the prospective benefits and drawbacks.

5. **Discount Future Earnings and Gains:** Time value of money must be taken into consideration when conducting cost-benefit analysis by setting future expenses and benefits at their current levels. This will assist you in comparing options that have varying realization timelines.

   For cost-benefit assessments, the standard discount rate is 7%. However, the particular circumstances and the accessibility of specific data may dictate that you utilize a different or higher rate.

6. **Determine the NPV, or Net Present Value:** Using the NPV (net present value) calculation, all of your expenditures and benefits are combined into a single figure that shows the anticipated financial consequences of each choice. It's used in finance almost exclusively.

   The computation looks like this:

   NPV = ((Benefits – Costs)/(1 + Discount Rate)^Time) – Initial Investment

Notes

In the context of a cost-benefit analysis, Net Present Value (NPV) is computed by adding the current values of every inflow and outflow throughout the course of the investment. How do your figures appear when the discount rate is taken into account over time?

An investment with a negative Net Present Value (NPV) is not anticipated to yield a positive return, whereas one with a positive NPV indicates that it will.

Note: The better, the bigger the NPV value. Additionally, a "good" NPV is greater than zero.

7. **Before deciding, Perform a Sensitivity Analysis:** Do a sensitivity test to learn how modifications to important assumptions impact your analysis's outcome, Also known as a "what-if" analysis, this kind of study enables you to observe how altering a single variable impacts the result.

   Let's take the scenario where you are thinking about funding a fresh marketing initiative. Although your ROI calculation only accounts for a 10% increase, you think this will result in a 20% increase in sales. You can find out how susceptible your investment has become to this assumption by running a sensitivity test.

   Choose the important factors from your cost-benefit analysis & alter them one at a time while maintaining the stability of the other variables to do a sensitivity analysis. This will enable you to observe the effects of each variable on the total analysis result and its degree of uncertainty.

   This means that you can then proceed to make an informed choice.

3.11 Swap Ratio

In a merger or acquisition, the ratio at which the acquiring company will exchange the shares of the target company for its own shares is known as the swap ratio. It is not necessary for the acquisition of a target company's shares in exchange for cash when two businesses merge or acquire one another. It may entail a stock conversion, where the swap ratio essentially describes as an exchange rate.

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In a merger or acquisition, the rate at which an acquiring firm will exchange the shares of the target company for its own shares is known as the swap ratio.

A multitude of criteria, including debt levels, dividend payments, earnings per shares, and profits, are taken into account when determining the swap ratio.

The number of shares in the acquiring firm's stock that target company shareholders will get for each share of target business stock that they now own is indicated by the swap ratio. An acquiring company would give four shares of the acquired business for every share in the acquired company, for instance, if it offered a swap ratio of 4:1.

A target company shareholder will ultimately own a greater number of shares than they did previously, but these new shares will belong to the acquiring firm and will be valued at the acquiring company's price. The target company's shares can disappear.

Businesses examine a range of financial and strategic indicators, including the value of the book, margin, payment of dividends, and debt levels, Earnings Per Share (EPS) to determine the proper swap ratio. The expansion of each firm and the justifications for the acquisition or merger are additional elements that affect the swap ratio. Although the swap ratio serves as a financial indicator, its ultimate value is determined by taking into account negotiations along with additional strategic factors in addition to financial analysis.

Along with their relative financial circumstances, the target & acquiring companies' stock prices are compared at the present market value. Next, a ratio is set up that indicates how often the owners of the target firm will get shares of stock from the purchasing company for each one share of the acquired firm.

Calculation of Swap Ratio: To ascertain the appropriate swap ratio, businesses look at a variety of financial or strategic variables, such as the book value, margin, dividend payments, debt levels, and Earnings Per Share (EPS). Other factors influencing the swap ratio are each company's growth and the reasons behind any mergers or acquisitions. The swap ratio is a financial indicator, but negotiations and other strategic considerations, in along with financial research, ultimately decide its eventual value.

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The stock prices of the target and acquiring companies are compared at their current market value in addition to their respective financial situations. Subsequently, a ratio is established to represent the frequency with which the target company's owners will receive stock from the buyer.

Any banking company's program can be approved by the shareholders. Additionally, the Indian courts did not express their opinions on how shares should be valued in order to determine share swap ratios.

Combining the asset value technique, market value strategy, and income strategy results in the right and fair valuation strategy for calculating the swap ratio.

Question. Business A and Business B intend to combine. The following is pertinent financial data for both companies:

Business A:

Market value per share: Rs. 50

There are 10,000,000 outstanding shares.

Revenue: Rs. 25,000,000

Business B:

Market value per share: 25 rupees

There are 5,000,000 outstanding shares.

Revenue: Rs. 10,00,000

Based on the firms' current market valuations, the boards of the two have approved the merger.

(a) Determine the swap ratio, or the quantity of business A shares that must be traded for every Share of the Business B.

(b) After the merger, ascertain the new shareholder structure.

(c) After the merger, calculate the resulting Earnings Per Share (EPS).

Solution:

(a) Calculating the Swap Ratio:

The market values of the shares of the two businesses are compared to calculate the swap ratio. It is the difference between the share prices of Businesses A and B.

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Swap Ratio: Market Price per Share of Company B/Market Price per Share of Company A

Swap Ratio = 50/25 **= 2**

Consequently, the owners will receive two shares of the business A for each share of Business B.

(b) New Shareholding Structure:

There are 5,000,000 outstanding shares of the business B.

Every share of Business B will have to be exchanged for two shares in Business A based on the swap ratio.

Total number of newly issued shares by Business A to shareholders of Business B:

5,000,000 × 2 = 10,000,000

Following the merger, Business A's total share count will be:

Shares Issued = New Shares Issued + Existing Shares of the Business A = 10,000,000 + 10,000,000 **= 20,000,000**

(c) Earnings Per Share (EPS) Combined:

The total of the two business's earnings will be the combined earnings for the new entity:

Total Earnings = Business A's Earnings + Business B's Earnings = 25,000,000 + 10,000,000 = 35,000,000

The combined value of the EPSs will be:

Combined EPS = Combined Earnings/Total share Outstanding = 35,00,000/20,00,000 = **1.75**

3.12 Summary

Business valuation encompasses various methods to determine a company's worth, crucial for strategic decision-making. The Discounted Cash Flow (DCF) approach is a popular method, focusing on future cash flow projections discounted to their present value. Economic Value Added (EVA) provides insights into a company's true financial performance by considering residual wealth. Sensitivity Analysis is employed to understand the impact of variable changes on business valuation. Slump sale

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valuation assesses the entire business sold as a going concern, while synergy valuation in mergers quantifies the financial benefits of combined operations. Cost-benefit analysis evaluates the financial implications of business decisions, ensuring informed choices. The swap ratio is vital in mergers, determining share exchange proportions. Mastery of these methods enables financial professionals to conduct comprehensive business valuations, supporting strategic planning and investment decisions.

3.13 Answers to In-Text Questions

1. *(c)* Discounted Cash Flow

2. *(b)* The percentage of shares that are traded between the merging businesses

3.14 Self-Assessment Questions

1. Explain the steps involved in valuing synergies in mergers and acquisitions and their significance. What effect do synergies have on the combined firms' total valuation?
2. Describe the DCF (Discounted Cash Flow) method of business appraisal. What are its primary elements and how is the value of a company ascertained using them?
3. What is swap ratio? How we can calculate it?
4. What do you mean by cost-benefit analysis?

3.15 Reference

- · Copeland, T., Koller, T., & Murrin, J. (2000). "Valuation: Measuring and Managing the Value of Companies." Wiley.

3.16 Suggested Readings

- Damodaran, A. (2012). "Investment Valuation: Tools and Techniques for Determining the Value of Any Asset." Wiley.
- Copeland, T., Koller, T., & Murrin, J. (2000). "Valuation: Measuring and Managing the Value of Companies." Wiley.

UNIT - IV

LESSON

4

Legal and Regulatory Framework of M & A

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STRUCTURE

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4.1 Learning Objectives

- Comprehend the key changes introduced in the Companies Act, 2013, regarding mergers and acquisition.
- Assess the implications of SEBI's revised takeover regulations on M&A activities.
- Analyze the provisions of the Competition Act, 2002, focusing on how it regulates mergers and acquisitions.

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4.2 Introduction

Ninety parts of the Companies Act, 2013 were notified by the Department of the Ministry of Corporate Affairs on December 7, 2016, and they came into force on December 15. These parts also contain the Chapter XV (parts 230–240) provisions on Arrangements, Compromises, and Amalgamations. The author of this essay aims to analyze the effects of the mergers and acquisitions-related laws to the Companies Act, 2013. In the process, some new concepts related to mergers and acquisitions that were introduced under the new Act have also been analyzed. Firstly, an analysis of the concepts which have been altered under the new Act has been conducted, followed by a comparison of similar provisions in the old Act.

The Companies Act, 2013's introduction marked a turning point in Indian corporate law history. When the Companies Act of 2013 was first introduced, it had 479 clauses, 29 chapters, and 7 schedules.

Since then, the Companies Act of 1956 has been gradually replaced by the new Act by the Ministry of Corporate Affairs. Ninety Sections of the Companies Act, 2013 were notified by the Ministry of Corporate Affairs on December 7, 2016, and they came into force on December 15. Additionally, the clauses on arrangements, compromises, and amalgamations found under chapter XV, namely Sections 230–240. Moreover, Businesses (Arrangements, Compromises, and additionally, notice was given of the Amalgamations) Rules, 2016, which became operative on December 15, 2016.

4.3 Comparison of Provision of Companies Act, 1956 and 2013

Sections in the Companies Act:

Earlier, Sections 391 to 394 within the Companies Act of 1956 regulate mergers and acquisitions. It will be controlled by Sections 230 to 232 of the New Companies Act, 2013.

Important M&A-related Changes under the New Act, 2013:

- Notice of Meeting
- Annexed to the notice is the valuation certificate, which is part of the scheme.

- Auditor's certificate attesting to adherence to accounting rules.
- Opposition to a deal or compromise: Creditor/Shareholder.
- Amalgamation or merger of the business with a foreign business.
- Fast Track Merger

(a) **Notice of Meeting:** The 2013 Act mandates that, in addition to the Central Government, notice of the meeting seeking approval of the proposal of compromise or agreement and other papers be provided to various additional regulatory agencies who are probably going to be impacted by the agreement or arrangement.

Interpretation and Consequences: The current one-party process for filing documents with the court is going to turn multi-party when different regulatory bodies are involved. With the direct engagement of additional regulatory agencies, the procedure may grow more onerous and involve more paperwork.

(b) **Valuation Certificate:** The valuation report's disclosure to shareholders is not required by the 1956 Act. The valuation certificate must now be included in the system by law according to the 2013 Act. An attachment containing the valuation report must be sent with the notice of meetings for scheme approval.

Interpretation and Consequences: As a result, the shareholders will be able to make an informed decision and comprehend the transaction's business justification. The company should get a strong value study because it will now be subject to examination from multiple stakeholders.

(c) **Adherence to Accounting Standards:** The company's auditor has certified that the proposed scheme's accounting treatment complies with the new Act 2013's requirements for accounting standards.

In addition, the auditor's certificate attesting to the application's compliance with accounting rules must be submitted to the tribunal along with the request for a reduction in share capital.

Interpretation and Consequences: In order to prevent the use of creative accounting techniques for financial re-modeling from being approved by the courts, the 2013 Act harmonizes SEBI requirements that were previously applicable to listed firms with those of all other companies.

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The auditor now has to verify that accounting rules have been observed because the scheme tends to have a superseding influence on accounting treatment (particularly when it comes to the treatment of reserves, as stated in accounting standard 14).

(d) **Compromise or Arrangement Objection:** In accordance with the 1956 Act, if a shareholder, creditor, or other "interested person" feels that their interests will be negatively impacted by the compromise or arrangement, they may file an objection with a court. According to the 2013 Act, only individuals may protest to a compromise or arrangement: possessing at least 10% of the shares or, according to the most recent audited financial statements, having debt of at least 5% of the total debt.

Interpretation and Consequences: The newly formed threshold limit for objecting to a scheme and arrangement will shield the plan against pointless lawsuits and objections from creditors and small shareholders.

(e) **Combination or Merger of a Firm with a Foreign Company:** The 1956 Act prohibits for the combination of an Indian company with a foreign company (the recipient company needs to be an Indian organization).

The 2013 Act specifies that the same rules will apply to mergers between Indian corporations and companies in foreign jurisdictions that have been notified. Reserve Bank of India clearance would be necessary beforehand, and the consideration of the merger might take the form of cash, depository receipts, or both.

Interpretation and Consequences: The Act of 2013 will give Indian companies the chance to grow and expand by allowing them to merge with global companies or the other way around. This will present a chance to formulate worldwide corporate strategies. It has to be evaluated if the mechanism of implementation is sufficiently seamless.

According to the 2013 Act, the aforementioned provision will henceforth apply to all cross-border mergers. At the moment, any foreign company operating in any jurisdiction can combine with an Indian corporation. This could now only apply to businesses in jurisdictions that have been notified.

(f) **Fast-track Merger:** All amalgamations and mergers must receive judicial permission in accordance with the 1956 Act. According to the 2013 Act, court approval is not necessary for mergers and amalgamations involving two or more small businesses, holding corporations and their wholly-owned subsidiaries, or other firms as may be prescribed.

ROC OL must be notified, though, and members must be presented with any objections or suggestions. Members possessing a minimum of 90% of the total shares or creditors representing 90% of the value of the creditors or the group of creditors of the corresponding corporations must accept the scheme. Notification must be sent to all, the Central Government, ROC, and Official Liquidator upon approval of the program.

Interpretation and Consequences: This will shorten the length of court hearings and expedite the resolution of the case. It will facilitate the process of streamlining judicial proceedings by assisting in the removal of bureaucratic obstacles.

As of right now, it appears that these fast-track mergers do not additionally need to provide an auditor's certificate of compliance with the accounting standard, a value report, or notices to the RBI or income tax. Transitional requirements pertaining to ongoing restructuring are not specified in the 2013 Act, and there is currently a lack of information in this regard.

To conclude, we can say that:

The manner corporate restructuring is carried out in India will change significantly as a result of the new approved sections. The new rules aim to improve transparency and speed the procedure. Moreover, the NCLT's jurisdiction over these issues will promote uniformity and expedite the entire process. Through judicial approval, the 2013 Act gave many of the corporate restructuring techniques that were already in use statutory force.

4.4 SEBI Takeover Code 2011

Over the last few years, the traditional takeover regulations have controlled M&A transactions in India. In this time, the business world has seen significant change. It appears that SEBI has now come to the realization that these regulations require revision in order to remain current with the

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rapidly evolving global landscape. For this reason, the SEBI announced the revised acquisition guidelines earlier this year. The legislation governing the takeover procedures of listed firms in India dates back more than a decade. It is known as the SEBI (Substantial Acquisition of Shares and Takeovers) under the Regulations, in 1997 (Takeover Code or Takeover Regulations), and it was created by the Securities and Exchange Board of India (SEBI).

India's M&A environment is about to shift, and this time for the better. (SEBI), The Securities and Exchange Board of India, revised the antiquated takeover regulations on September 23, 2011, and notified the market of the new rules in an effort to bring them more in line with international standards. Despite the fact that many industry professionals are in favor of the recently implemented takeover law, certain voices are still not entirely in agreement. The primary goal of the new takeover law is to deter aggressive takeovers while also giving innocent shareholders who don't want to be associated with a certain acquirer additional options for exiting the company.

Restrictions on Obtaining Shares or the Ability to Vote

First Threshold Limit: A rise in the threshold limit to 25% from 15% gives acquisition more leeway. For buyers with a minimum of 15% but not more than twenty-five percent of the target company's voting rights, there is no transition clause. Any individual, acting alone or in concert with PACs (collectively, the acquirer) may purchase up to 24.99% of the voting rights or shares in an Indian listed business (the target company), so long as the acquirer is not taking control of the target business. The acquirer shall make an open invitation to purchase at least 26% of the target business's shares from the current public shareholders in terms of the acquisition if it results in the acquirer being entitled to 25% or more of the vote in the target company.

Limit on Creeping Acquisitions: Up to the maximum amount of legal non-public shareholding—typically 75%—a sliding acquisition of 5% is permitted within a fiscal year. In any fiscal year, the acquirer who holds a minimum of 25% of the target company's voting rights may purchase extra voting rights or shares for up to 5% of the total voting rights, subject to the maximum allowable non-public shareholding limit, which is often 75%.

Any financial year in which voting rights are acquired in excess of 5% is required to conduct an open offer. The aforementioned 5% creeping acquisition limit will be calculated as follows: Gross acquisitions will be taken into account without deducting any decrease in shareholding or voting rights resulting from share sales or voting rights being diluted from new shares issued by the target firm.

The gap between the pre- and post-allotment proportion of voting rights is going to be considered the amount of additional acquisition in the event that the target firm issues new shares to the acquirer.

Acquisition of "Control": Merely by holding a position of authority, an officer or director of the target firm is not deemed to have control over it. The 1997 Code does not cover the takeover code's exemption from the open offer requirement due to a change of control from joint to sole control. Acquisition is regardless of the number of shares or voting rights owned, the acquirer's direct or indirect acquisition of control results in an open offer obligation. Three types of indirect acquisition of managerial authority or control exist, depending on the target company's value* in relation to the whole transaction. Different criteria apply to different types of indirect acquisitions, including offer timing, disclosures, and offer price computation. The Takeover Code fails to eliminate the open offer requirement for a change in control that results from a special resolution of the target company's shareholders (a feature known as the "whitewash provision," which was accessible in the 1997 Code).

Offer in Progress: Conditions and Triggers

Open Offer Requirement: Any of these circumstances can result in an obligatory open offer: Purchasing significant voting rights or shares that provide the acquirer access to at least 25% of the target company's voting rights.

The acquisition of over five percent of the target company's rights to vote in a fiscal year by an acquirer who already owns at least 25% of the company's voting rights. Acquisition of power over the selected company, regardless of the acquirer's ownership of shares as well as voting rights.

As per the Takeover Code, an acquirer must propose to purchase a minimum of 26% of the target company's shares from public shareholders in a mandated open offer.

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Open Voluntary Offer: An acquirer with at least 25% of the target company's voting rights may make a voluntary offer of a minimum of 10% of the target company's total shares. The following requirements must be met in order for this to happen:

The acquirer's total shareholding after the open offer shouldn't be more than the maximum amount of legally allowed nonpublic shareholding, which is usually 75%.

It is improper for the acquirer to have purchased shares of the company being acquired in the 52 weeks prior to the open offer obligation.

There are guidelines for voluntarily open offers.

The minimum offer size has been lowered from 20% to 10% in order to encourage equitable and open shareholding consolidation.

Essential Components of Open Offer Duties

Size of Offer: Starting on the tenth working day following the end of the tendering process, the target company's total share count must be subtracted to determine the required offer size of 26%. All potential rises in the amount of shares in circulation during the period of offer considered as of the PA date should be factored into the entire number of shares as on the tenth working day. The offer size must be adjusted proportionately in the event that the overall amount of shares post-PA increases above what was anticipated on the PA date. The interested party and manager will decide what to offer if the open price cannot be established for an indirect acquisition, taking valuation characteristics into consideration between:

The date of contracting for the primary acquisition or, if announced earlier, the date when the primary acquisition decision was made.

The day when the target company's shareholders receive the PA

If the target firm's worth surpasses 15% of the total transaction, an indirect acquisition for the target company will require valuation, which must be disclosed. Non-compete clauses have to be included in the agreed price, which will serve as the starting point for calculating the offer price.

Payment Method: Offer price can be paid with any one of the following methods, or with any combination of them:

Cash

Issue, trade, or conveyance of:

1. The acquirer's or PACs' listed equity shares
2. Debt instruments that are listed and have an investment-grade rating that are issued through the acquirer or PACs.
3. Debt securities that are convertible and grant the holder the right to purchase listed shares from the purchaser or PACs

Offer with conditions: An acquirer has the option to make an open offer with requirements for a minimum level of acceptance. If an offer is made in accordance with an agreement, the agreement must provide that the purchaser will not purchase any shares through the open offer if the required level of agreement is not met.

Rival Offer: A rival offer may be submitted by the acquirer whoever makes the initial payment within 15 business days of the DPS date.

It is not possible to make the competing offer conditional on the minimal level of acceptance unless the initial open offer is conditional.

All the rules of the Takeover Code, including the offer size clause, are applicable when there is a competing bid since it is not considered a voluntary open offer.

An acquirer who presented a previous offer may amend the terms of his open offer upon payment of a competing bid, provided that the revised terms are more advantageous to the target company's shareholders.

Offer Withdrawal: An open offer may be withdrawn in one or more of the following situations after it has been made:

If the DPS and LO disclose the need for approval, statutory permits for open offers or acquisitions that trigger the need to make an open offer are denied.

As any normal person would, the acquirer passes away.

If the requirements have been stated in the DPS and LO, any condition specified in the contract for purchase that attracts the obligation to submit an open offer is not met due to circumstances outside the acquirer's control.

In the view of SEBI, there are further circumstances that warrant withdrawal.

Notes

To conclude we can say that:

In the distinct and unusual Indian business climate, where complex cross-holdings and fake shareholders have been the norm, the Takeover Code has withstood the test of time. SEBI has worked to improve the effectiveness and efficiency of the Code with each update.

Additionally, the code has been streamlined, balanced, and expanded in its applicability by this change. One of the best securities market regulators in the world has always been SEBI. Its attempts to improve the securities market's sophistication, fairness, and cleanliness are admirable. Even though the smallest offer size and threshold limit have increased due to the revised takeover code.

Additionally, it is believed that the RBI should remove the prohibition on banks financing domestic acquisitions. By creating the new takeover code, the SEB has completed one step of the reform process effectively; its proper implementation is the remaining requirement. Let's hope it can pull that off.

IN-TEXT QUESTIONS

1. Under the Companies Act 2013, who must be notified about the meeting seeking approval of a merger or acquisition proposal?

(a) Only the Central Government

(b) Central Government and additional regulatory agencies

(c) Shareholders and creditors only

(d) The RBI

2. According to SEBI revised takeover regulations, what is the new threshold limit for an acquirer to make an open offer?

(a) 10% *(b)* 15%

(c) 20% *(d)* 25%

4.5 Competition Act 2002 - Provisions for Merger and Acquisition

India has reacted to the globalization movement by liberalizing, deregulating, and opening up its economy. This naturally implies that our Indian market needs to be prepared for both domestic and foreign competition. In view of global economic trends, particularly those pertaining to competition legislation, the Monopolies and Restrictive Trade Practices Act, which was made in 1969 has grown rather out of date. Instead of concentrating on limiting monopolies, we should instead be supporting competition.

The Competition Act of 2002 was passed by the Indian government in accordance with the aforementioned ideology. The Competition Act (henceforth referred to as the "Act") forbids commercial activities that have a discernible negative impact on market competition in an effort to promote fair competition in India. To that end, calls for the creation of a quasi-judicial organization to be known as the Competition Commission of India (henceforth referred to as "CCI"), which will also engage in competition advocacy in order to raise public awareness and give training on competition-related matters.

The Act's regulation of acquisitions and mergers is one of its primary features. The goal of this study is to conduct a critical analysis of the Act's merger and acquisition regulation provisions.

The Competition Act

The Competition Act 2002 ("Act") is the most recent component in the nation's economic reform puzzle, having been brought into Parliament in August. The Monopolies and Restrictive Trade Practices Act 1969 (henceforth referred to as the "MRTP Act") will be superseded by the Act. While the new Act is based on ideas of competition law that are found within more liberalized economies like the US and EU, the MRTP Act was created to regulate restrictive trade practices within the framework of a restricted and centrally planned economy. For multinational corporations ("MNCs") doing business in India, it is especially important to note that the new regulatory body being proposed, All mergers, acquisitions, and joint ventures in India where the parties' combined asset value exceeds Rs. 1,000 crore in India or $500 million worldwide, or where the turn-over exceeds Rs. 3,000 crore in India or $1,500 million worldwide, will be subject to scrutiny by the Competition Commission of India ("CCI").

There are four major parts to the Act:

Prohibition of Agreements which Prevent Competition;

Preventing the Abuse of Dominance

The control of acquisitions and mergers;

Formation of the 10-member CCI.

Notes

(a) **Prohibition of Agreements (Anti-Competitive) which Prevent Competition; Section 3:** Prohibits and nullifies any deal that has the potential to significantly harm India's competitive environment.

Has an assumption against agreements which regulate production, the supply, markets, advancement of technology, investment, or the delivery of services; share markets as well as sources of production through geographic allocation, different types of goods or services, or market shares; or that, directly or indirectly, lead to bid rigging or collusive bidding.

(b) **Preventing the Abuse of Dominance Section 4:** Abuse of a position of dominance could include:

Putting restrictions on the buying or selling of services or goods that are unjust or discriminatory, or determining prices for the buying or sale of products or services that include predatory pricing;

Restricting or limiting the supply of commodities, the market for them, or their production; or limiting the advancement of science or technology in connection with goods or services at the expense of consumers;

Engaging in an activity or actions that lead to the exclusion from a market;

Requiring other parties to accept additional duties that are unrelated to the subject matter of the contracts before concluding them;

Making use of a strong position in a particular market to enter or defend another.

(c) **The Control of Acquisitions and Mergers; Section 5:** Prohibits and eliminates any "combination" that has the potential to significantly harm competition inside the relevant Indian market.

The following cutoff points determine whether a purchase or merger qualifies as a "combination" that needs to be closely examined:

Businesses that operate within India:

Rs. 3,000 crore in turnover or Rs. 1,000 crore in asset value;

Businesses that operate internationally:

$1,500 million turnover or $500 million in asset value;

Groups of businesses that operate in India:

Asset value of Rs. 4,000 crore or a turnover value of Rs. 12,000 crore;

Groups of businesses that operate internationally:

$6 billion in turnover or $2 billion in asset worth.

(d) **Formation of the 10-member CCI:** Establishes a 10-member CCI with judicial and investigative authority. There will be a new MRTP Commission led by the CCI.

The CCI is authorized to investigate the possibility of a significant negative impact on competition in the country resulting from a "combination" as defined by section 5. Any such investigation needs to be started within a year of the merger going into force.

Upon receiving a complaint, CCI may also look into any action that is purported to violate Section 3 as well as Section 4.

CCI has the authority to issue a variety of directives, including as ordering a business to end a certain agreement or activity (such as demerging); imposing fines equal to three to ten percent of the company's turnover for the previous three years; and changing agreements.

4.6 Prohibition of Abuse of Dominant Position

The Competition Act of 2002 allows an organization to benefit from its dominant position, or strength in an appropriate market, both inside and outside of India. This allows the organization to function independently of the competitive forces that exist in the relevant market and to influence consumers, competitors, or markets that are relevant in its favor. On the other hand, Section 4 in the Act forbids any business from exploiting its dominating position. When a business uses its dominating position to impose unfair terms or pricing requirements, such as predatory pricing, on buyers or sellers of goods or services, it is seen to be abusing its position or either it restricts or limits the market for products and services, their production, or the advancement of science and technology related to these goods and services; or it denies others access to the market; or they sign agreements with terms that have nothing to do with the topics covered in the contract; or makes use of its strong position to break into or defend another important market.

Notes

The CCI may investigate any suspected violation of domination by an entity within the provisions of section 19 of this Act, either through its own initiative or in response to an accusation or reference. The elements that the CCI must take into account when determining whether or not an enterprise has a dominant position are outlined in Section 19(4). Among the elements mentioned therein are:

The enterprise's market share;

The enterprise's size and resources;

The magnitude and significance of the rivals;

Economic strength of the business, which includes its ability to outperform rivals in the market;

Vertical integration of its businesses; its ability to sell or provide services to other businesses; and the reliance of its customers.

Like in the situation for anti-competitive contracts, the CCI has the authority to order the business or individual to stop misuse of its dominant position, compensate the harmed parties, and fine the party using the advantage of dominant position up to 10% for the average turnover for the three previous fiscal years. In order to prevent the firm with a dominant position from abusing it, the CCI may also suggest that the Central Government must be separated.

It is important to note at this point that the legislation does not forbid or prevent businesses from gaining dominance. There is absolutely no control to stop businesses from assuming or gaining a dominant position. The inappropriate use of such a dominant position is the only thing that the Act forbids. Thus, rather than focusing on dominance in general, the Act focuses the abuse of dominance. This is a positive step in the direction of a fully liberal and global economy, so thank you.

4.7 Regulation of Combination

Only mergers and acquisitions that meet the requirements of Section 5's definition of combinations are subject to regulation, according to the applicable Act provisions. At the moment, the only factor determining whether mergers and acquisitions must undergo a post-merger review is size. There are other, perhaps more reasonable, criteria that are left out, like the market share held by an industry participant or the size of the market in a given industry. There are no rules governing mergers and acquisitions which do not qualify as combinations but could nevertheless have a negative impact on competition. There may be circumstances in which a merger does not meet the criteria for a combination but yet raises significant questions about market competition.

Actually, every investment made in India by a big international corporation will surpass the criteria outlined in Section 5 according to a study conducted by the Association of Chambers of Commerce in India. No matter the position that the investment or joint venture would take in the market, the Competition Commission of India (CCI) is given the authority to look into the arrangement. On the other hand, a smaller business that might hold an advantage within the same market might not fit the requirements and might get away with an examination.

The specified threshold values do not in and of themselves make the merger undesirable; rather, they merely act as a catalyst for the investigation process. A more thorough examination would be conducted by the CCI prior to any action being taken against the specific merger. But given the peculiarities associated with the Indian economy including the volatile exchange rates, there is little use for the threshold values. It is therefore recommended that a good compromise would be to specify multiple criteria, a violation of even one among which could lead to an investigation, such as market share, asset valuation, and net turnover.

Sections 5 and 6 of the Act are specifically designed to prohibit combinations that have the potential to materially harm competition. It is difficult to see how the aforementioned can be accomplished without taking the combined firms' market shares into account. Company "A" and company "B" combine. Despite having asset values and turnover over the allowed threshold, A and B do not view their merger as anti-competitive. The two businesses don't disclose their merger to the CCI. During the initial six months of the merger, the corporations invest a significant sum of money. Following receiving of information by a rival, the CCI conducts an investigation and, within the first year of a merger, renders a decision stating that the merger should not go forward due to its detrimental impact on competition. In this instance, the CCI's order will cause the two combined companies to suffer enormous losses.

Notes

Introducing pre-notification of combinations required for all businesses with the required asset worth and turnover will eliminate this disparity. Put another way, it should be required rather than voluntary that each combination that exceeds a certain threshold notify the CCI in order to avoid conflicts. As required by Section 31(11), the CCI may then provide a decision within 90 working days of the combination's details being published.

In fact, the goal of the recently passed Competition Act has been to encourage a merger-friendly mindset. It's hard to argue against the Act's notable contributions to this school of thought. Nevertheless, the Act does not make this objective very apparent.

In the previous section, a few irregularities and low points under the Act were mentioned. Although the remarks made there and the recommendations which follow are not extremely broad in scope, their importance comes from their ability to make the legislature's intentions clear. The aforementioned recommendations aim to improve the Act without going against its spirit and to provide a more significant and maybe more successful result.

4.8 Summary

Sections 230 to 232 of the Companies Act, 2013, which replaced sections 391 to 394 of the 1956 Act, marked a substantial change in the control of mergers and acquisitions (M&A) in India. Important modifications include the requirement to provide notices to more regulatory bodies, the provision of a valuation certificate for transparency, and the use of auditor-certified accounting standards. In an effort to expedite the process and lower administrative barriers, the Act also included provisions for international mergers and a fast-track approach for mergers involving small businesses or wholly-owned subsidiaries.

With effect from 2011, SEBI's new takeover regulations raised the necessary open offer threshold from 15% to 25% and added the notion of creeping acquisitions, which permits up to 5% more acquisitions every year without resulting in an open offer. The goal of these rules is to prevent aggressive takeovers while still protecting shareholder interests.

These modifications are enhanced by the Competition Act of 2002, which places more emphasis on combating anti-competitive behaviour. It controls acquisitions and mergers that surpass certain asset or turnover limits and are subject to Competition Commission of India (CCI) review. The Act forbids actions that limit competition or take advantage of a dominant market position. It also covers abuse of dominance. The overall goal of these legislative and regulatory measures in India is to promote an open, competitive, and effective business environment.

4.9 Answers to In-Text Questions

1. *(b)* Central Government and additional regulatory agencies

2. *(d)* 25%

4.10 Self-Assessment Questions

1. Discuss the main modifications to the merger and acquisition regulations brought about by the Companies Act of 2013. In what ways do these modifications seek to enhance the corporate restructuring process and transparency in India?
2. Examine how the updated takeover laws by SEBI have affected India's M&A market. What are the primary goals of these rules, and how do they attempt to safeguard the interests of shareholders?
3. Examine the sections of the Competition Act, 2002 that deal with acquisitions and mergers. How does the Act make sure that these business practices don't undermine market competition? Give examples to support your arguments.

4.11 Suggested Readings

- sebi.gov.in/sebi_data/faqfiles/mar-2022/1648620806406.pdf
- Gupta, M. (2010). Contemporary Issues in Mergers and Acquisitions. Himalaya Publishing.
- Sundarsanam. (2006). Creating Value from Mergers and Acquisitions (1st ed.). Pearson.

Glossary

Combination: Mergers, acquisitions, or amalgamations that meet certain asset or turnover thresholds, subject to scrutiny under the Competition Act, 2002.

Consolidation: Combining two or more companies into one entity to increase market share and efficiency.

Creeping Acquisition: The gradual purchase of shares by an acquirer, allowing up to 5% additional acquisition within a fiscal year without triggering an open offer.

Cross-Border Merger: A merger involving companies from different countries, often with additional complexities such as regulatory and cultural differences.

Discounted Cash Flow: A valuation method that estimates the value of an investment based on its expected future cash flows, which are discounted to the present value.

Disinvestment: Selling off assets to reduce ownership and reallocate funds.

Dominant Position: A state where a company can operate independently of competitive forces in the market, regulated under the Competition Act, 2002, to prevent abuse.

Due Diligence: A comprehensive appraisal of a business undertaken by a prospective buyer, particularly to establish its assets and liabilities and evaluate its commercial potential.

EVA: A measure of a company's financial performance that shows the residual wealth created after deducting the cost of capital

Fast Track Merger: A simplified merger process under the Companies Act, 2013, for small companies or wholly-owned subsidiaries that do not require court approval.

Financial Restructuring: Altering a company's debt and equity composition.

Hostile Takeover: An acquisition attempt by a company or raider that the target company resists or opposes.

Hubris: A theory suggesting that managers overestimate their ability to manage a target company, often leading to overpayment during acquisitions.

Open Offer: A public offer made by an acquirer to purchase shares from existing shareholders, mandated when certain thresholds are crossed under SEBI regulations.

Reverse Synergy: The value of a single unit exceeding the combined value of multiple units.

Notes

Sensitivity Analysis: A technique used to predict the outcome of a decision given a certain range of variable.

Slump Sale: The transfer of an entire business unit or company as a going concern.

Strategic Alliance: Agreement between companies to collaborate on shared business objectives.

Swap Ratio: The ratio at which one company's shares are exchanged for another's in a merger or acquisition.

Synergy: The additional benefits obtained when two companies merge, leading to a value greater than the sum of their individual values.

Valuation Certificate: A document that provides an estimate of the value of the company being merged or acquired, required to be disclosed to shareholders under the Companies Act, 2013.

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