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Volume 30, January 2024 ISSN 2581-5504

"Merger and Acquisition in India and their Impact on Shareholders"

Vedang Sharma
Shri Vaishnav Vidhyapeeth Vishwavidyalaya
Indore

ABSTRACT

Businesses serve as fundamental avenues of innovation and economic development in any country, contributing significantly to its GDP. As companies solidify their presence and establish stable profit margins, it is natural for them to incline towards expansion and diversification of their company to explore the possibilities offered by mergers and acquisitions (M&A). Mergers and Acquisitions significantly shape the economies of growing nations, as seen clearly in India's vibrant business scene.

In recent times, the Indian Mergers and Acquisitions (M&A) market has seen a massive surge in deals spanning across diverse number of sectors such as telecommunications, technology, pharmaceuticals, and manufacturing. This increase in deals not only highlights India's potential but also emphasizes its growing appeal for investing to both domestic and international investors. Companies with the use of M&A can strategically consolidate their operations, improve their competitive edge over others, and foster sustainable growth in an increasingly competitive market. This article aims to provide comprehensive insights into the complex world of M&A, offering a holistic understanding of its effects on shareholders within the Indian market.

Keywords: Acquisitions, Economies, Indian Market, International Investors and Mergers.

1. INTRODUCTION

When a merger or acquisition occurs within a company, its impact is not only felt by the involved companies but also among their shareholders. Such a huge transformation can lead to multiple outcomes for the investors which might range from positive to negative repercussions. Therefore, it becomes necessary for us to delve into the intricacies of mergers and acquisitions and understand the regulatory framework that governs these activities. It is also important for us to understand and examine the impact felt by Indian shareholders when an M&A occurs.

2. MERGERS: MEANING AND TYPES

2.1 What is a Merger?

A merger is said to be an agreement or a deal that unites or combines two existing companies into a single new company. There are many reasons as to why companies decide to merge. One of the main reasons for a merger occurs is when a company finds it suitable and advantageous to merge with a business with another company to increase its shareholder value. These include expanding a company's reach, exploring new segments, or gaining market share. Many times,

Volume 30, January 2024 ISSN 2581-5504

during a merger, companies have a no-shop clause that is used to prevent purchases or merges that might occur from other additional companies[1].

A merger is an activity that is performed by many industries at large, for example in healthcare, telecommunications, financial institutions, private industries, etc.

But how does a merger work? A merger as explained earlier, is a fusion of two companies done voluntarily on equal terms for the establishment of a single new legal entity. The companies that are participating in a merger shall make sure that they are roughly equal or similar in size, value, customers, operations, etc. For this very reason, the term 'merger of equals' is used. When all of the above criteria match, the companies move forward with the agreement, and a new entity is formed.

2.2 Types of Mergers

A merger can be categorized into various types. This differentiation is usually done based on the goal of the companies. The following are the most common types of mergers[2].

- Horizontal Merger

A horizontal merger takes place when two companies that sell similar products and services, function in the same market, and have the same target audience come together to form a single company. This type of merger is extremely attractive to companies as it helps to dominate the market share and decrease market competition. However, just like the positives, there are negatives to this too.

When a company is formed under a horizontal merger, there is an increase in regulatory scrutiny and stringency which can lead to a loss of value if not realised. One of the prime examples of this type of merger is the integration of WhatsApp, Facebook, Messenger, and Instagram.

- Vertical Merger

A vertical merger is a merger that takes place between two companies that belong to the same industry but operate at different stages of production. This type of merger is perfect for those companies who want to streamline operations, boost their efficiencies, and save costs. However, the downside to this is it can cause a company to lose its flexibility to explore and introduce complexities in the management of the business.

There are two types of mergers in a vertical merger, these are forward integration and backward integration. Taking the example of the retail industry, in forward integration, the wholesaler might merge with a retail hence, moving forward. In backward integration, the wholesaler may move backwards to merge with the manufacturer.

[1] Naina Srivastava, Merger and Acquisition in India, 1(5) International Journal of Law Management and Humanities (2018).
[2] Ibid.

- Conglomerate Merger

A conglomerate merger is the type of merger that takes place between two or more companies that are not related to the same industry whatsoever. These firms may operate in different industries and geographical regions completely. There are two types in this merger as well, pure and mixed. In a pure conglomerate merger, the merged companies may continue to function separately within their original markets, whereas on the other hand, in a mixed conglomerate merger, the companies may try to look to expand their product or market reach as a whole[3].

While this type of merger can help a new company to grow its market share and branch out its business, it can prove to be challenging to merge as these dissimilar companies may raise the risk of cultural clashes and disruption of operations in business. One of the best examples of a conglomerate merger is the brand Mars a chocolate bar company, and Wrigley's a chewing gum company.

- Congeneric Merger

In a congeneric merger also known as concentric merger, the participating company have different products or service but function within the same market and have the same target audience. These companies might be indirectly competing with each other but most of the time their products may complement each other. As these companies share similar means of production, distribution, and technology, a congeneric merger helps the company to expand its lines of products which in turn increases its market share. One of the negatives of this merger is the fact that as these two companies already function in the same industry, it could limit their ability to diversify further. An example of this type of merger is the merger between the companies Exxon and Mobil which were in the natural gas industry[4].

- Market Extension Merger

This type of merger commonly occurs across various geographical regions. The main purpose of a market extension merger is for the two participating companies to expand their market reach.

- Product Extension Merger

In a product extension merger, two companies who are in similar industries may merge when their products complement each other. A specific product of the company is added to the product line of the company they are merging with. For example, in the food industry, Pepsi goes well while eating a pizza. So, if Pepsi and a company like Pizza Hut were to merge, it would be known as a product extension merger.

[3] Harpreet Singh Bedi, Merger & Acquisition in India: An Analytical Study, SSRN E-Journal (2010)
[4] Pratheek Pathak, Navita Nathani, Mergers and Acquisitions in India And Its Impact on Shareholders Wealth, 4(8) IRE Journals (2021)

Volume 30, January 2024 ISSN 2581-5504

- Reverse Merger

When a privately owned company merges with a publicly owned company, it is considered to be a reverse merger.

3. ACQUISITION: MEANING AND CONCEPT

3.1 What is an Acquisition?

When a company purchases most or all shares of another company to gain control of the other company, is said to be an acquisition. Purchasing more than 50% of a firm's stocks and assets shall allow the buyer to make decisions regarding the acquired firm without the company and its shareholder's approval. Acquisitions are extremely common in the field of business. It may occur with the approval of the target company or without. When there is an agreement between the two companies, there is often a no-shop clause during the entire process. We tend to hear about the acquisition of large well-known companies more often as it dominates the news. But in reality, the concept of mergers and acquisitions (M&A) occur between small-to-medium-sized business more often than between large firms[5].

3.2 What Makes a Company Go for Acquisition?

There are multiple reasons for the aforementioned question. Companies might want to expand their business, achieve a greater market share, reduce their production cost, or try out new avenues of business.

Acquisitions serve as crucial avenues for corporate expansion, allowing companies to take significant strides forward. A single acquisition can often yield the same level of organic growth that would typically take three to five years to achieve. These strategic moves often bring in a fresh customer base, which in turn opens up new potential revenue streams. Moreover, an acquisition introduces a new range of products or services, effectively bolstering the existing product portfolio and expanding avenues for sales growth.

The success of an acquisition heavily relies on the strength of the entire acquisition process, comprising aspects such as valuation, structure, and operational integration. Heavy emphasis should be placed on fostering discipline at every stage of this process. This necessitates careful resource planning across the organization and the formation of multidisciplinary teams. While the initial stages of the acquisition process may be financially focused, it's the subsequent sales and operational focus that holds greater significance. Effective project management and seamless interdepartmental coordination play a vital role in ensuring favourable outcomes. Companies that adopt a comprehensive integrative approach to managing acquisitions tend to yield the most promising returns, whereas those that overly prioritize financial aspects at the cost of operational planning and integration often fall short.

[5] Naina Srivastava, Merger and Acquisition in India, 1(5) International Journal of Law Management and Humanities (2018)

4. LAWS REGULATING M&A IN INDIA

The concept of businesses merging and overtaking occurs a lot more regularly than we may imagine. As per Indian law, company takeovers are known as acquisitions, and mergers between the two are referred to as 'Amalgamation'.

4.1 The Companies Act, 2013

Sections 230-240 of the Companies Act of 2013 cover all provisions relating to mergers and acquisitions in India. It covers aspects such as companies, their members, and their creditors. Except for Section 234 of the act, all other sections were implemented in 2016, the former enforced in the year 2017[6].

Section 233 read with Rule 25 of the CAA deals with fast-track merger[7]s. It was inserted to prevent companies from having to go through lengthy procedures as per Section 232 of the act. All the company needs to do to go through with the deal is the approval of the shareholders, directors, creditors, etc.

Section 237 of the act has given the central government the power to form a merger with a company in the name of public interest and lays down the procedure to do the same as well[8].

The National Company Law Appellate Tribunal (NCLAT) established under this act has the authority to deal with all grievances related to company law including in the cases of a merger or an acquisition.

4.2 The Indian Income Tax Act of 1961

The term 'Amalgamation' has been defined under this act under Section 2(1B)[9]. It states, that a merger between two or more companies forming a new company is said to be an amalgamation. The company that has been merged is said to be the company that is amalgamating and the company that has been formed is said to be an amalgamated company.

In the context of amalgamation, certain transactions are exempted from capital gains tax under Section 47 of the Act[10]. These include:

- When the amalgamated company is an Indian company, any assets transferred by the amalgamating company to the amalgamated company are exempted from capital gains tax.
- If a shareholder transfers shares in an amalgamated Indian company and receives an allotment of shares in the same amalgamated company, no capital gains tax is levied.
- In the case of an amalgamation between two foreign companies, no capital gains tax is imposed.

[6] The Companies Act, 2013 (Act 18 of 2013), s. 234.
[7] The Companies Act, 2013 (Act 18 of 2013), s. 233.
[8] The Companies Act, 2013 (Act 18 of 2013), s. 237.
[9] Income tax Act 1961 (Act 43 of 1961), s. 2(1B).
[10] Income tax Act 1961 (Act 43 of 1961), s. 47.

- When an Indian company amalgamates with a foreign company, and the resulting company remains in India, no capital gains tax is imposed on shareholders.

Apart from these provisions, the income tax laws also exempt inherited property from capital gains tax, as there is no sale or transfer of ownership involved. Similarly, if a property is transferred by way of a gift or a will, no immediate capital gains tax is applicable. However, if the recipient subsequently sells the property, any profit earned from the sale may be subject to capital gains tax.

4.3 Foreign Exchange Management Act (FEMA), 1999

The Foreign Exchange Management Act (FEMA) of 1999 is the key legislation in India that governs cross-border mergers, covering mergers, amalgamations, or arrangements involving Indian and foreign companies[11]. The regulations stipulate that all cross-border transactions must be conducted through the Reserve Bank of India (RBI), as outlined in the 25th rule of the Compromise, Arrangements, and Amalgamation Rules of 2016. In 2017, the Companies Act was amended to include Section 234[12], specifically addressing cross-border mergers. The RBI, in 2018, issued an official gazette inviting stakeholders to discuss regulations, indicating its significant role in overseeing market situations.

Cross-border mergers are typically classified into two types: inbound and outbound. In an inbound merger, a foreign company merges with an Indian company, with all assets and liabilities transferred to the Indian company. An example of this is the acquisition of Ranbaxy by Daiichi. On the other hand, an outbound merger involves an Indian company merging with a foreign company, transferring all assets and liabilities to the foreign company. An example of this is Tata Steel's acquisition of Corus.

4.4 SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations of 2011 are essential for mergers, acquisitions, amalgamations, compromises, and arrangements involving listed companies. The regulation mandates that an acquirer who acquires substantial shares or voting rights, specifically 25% or more, must make an open offer to all the public shareholders of the target company. Moreover, irrespective of the shares or voting rights acquired, the acquirer must also make an open offer upon gaining control of the target company.

Understanding the term 'control' and its implications becomes crucial in this context. However, due to conflicting definitions of 'control' in Indian legislation and courts, along with ambiguous interpretations of the term, there remains a lack of a comprehensive definition. Recognizing this ambiguity and its potential impact on investors in the Indian public sphere, the Securities and Exchange Board of India (SEBI) sought to define 'control' and initiate a public discussion

[11] The Foreign Exchange Management Act, 1999 (Act 42 of 1999).
[12] The Companies Act, 2013 (Act 18 of 2013), s. 234.

process. This effort aims to bring clarity to the concept of 'control' within the framework of these regulations.

5. IMPACT ON SHAREHOLDERS

Several factors affect the shareholder when a merger or acquisition takes place. This process of merging and acquiring a company can have both positive and negative effects on the shareholders. It can lead to losses as well as profits in the market. This estimation of profit or loss depends on the due diligence exercised by the company while making a comprehensive analysis of the participating company's operations, finances, etc. A successful merger or acquisition also depends on such factors including factors such as strategies of the companies, effective integration of the company's workings and environment, and whether they can achieve synergies.

Following are the effects a shareholder might feel when a company goes through with M&A:

- Change in Stock Price:

  A shareholder's profits mostly depend upon the share price of a company. These prices can either increase or decrease when a merger or an acquisition takes place. One of the contributing factors to this change might be related to how the market reacts to such a deal. If the market perceives this agreement as a way for the company to create value, then the stock price may go up but otherwise, it may fall leading to massive losses to the shareholders[13].

- Cash or Stock Consideration:

  When a company merges with or is acquired by another, shareholders can receive payment in the form of cash, company stock, or a combination of both for their shares. The type of payment they receive determines their future relationship with the company. If they get cash, they have the option to invest elsewhere. On the other hand, if they receive stock, their association with the company becomes stronger[14].

- Control of the Company:

  The extent of control for existing shareholders during a Merger or Acquisition can vary. If the acquiring company holds a significant stake, the control of existing stakeholders might weaken, which can have both positive and negative implications, depending on the specific goals and expectations of the stakeholders involved.

- Synergies

  Mergers and Acquisitions create synergies and cost savings that enhance the companies involved. When two companies combine, they benefit from economies of scale, meaning

[13] Sanya Singhal, Prajal Joshi and Shruthi Reddy L, Comparative Analysis of the Effect of Mergers and Acquisition on Stakeholders: India & USA, NUJS Journal of Regulatory Studies (2023)
[14] Ibid.

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the cost per unit of output decreases as the operation size increases. Additionally, this union fosters cross-selling opportunities and reduces procurement costs, ultimately boosting the company's profits.

- Integration Risk

Mergers and acquisitions can bring about complex integration processes, which might negatively affect shareholders due to increased costs and reduced performance. Given that shareholders invest their hard-earned money in these companies and are key stakeholders, it is crucial to have strict regulations in place. In India, various rules and regulations safeguard the interests of shareholders during mergers and acquisitions (M&A). For instance, the Companies Act, 2013 mandates that companies obtain prior approval from shareholders through a special resolution with a minimum of 75% of the votes cast. Companies are also required to provide shareholders with essential information, including valuation reports, share exchange ratios, and the scheme of arrangements[15].

6. LAWS PROTECTING SHAREHOLDERS

Under the SEBI Regulations 2011, certain rules have been set in place to protect the interests of minority shareholders. These provisions make it mandatory for the acquirers to make an open offer to the said shareholders if they were to acquire more than 20% of the shares of the company.

The Competition Act of 2002 oversees M&A transactions to prevent them from causing unfair market practices or the misuse of market power[16]. Any significant M&A deal that could seriously affect competition must be reviewed by the Competition Commission of India.

Under the Income Tax Act of 1961, shareholder interests are safeguarded through tax exemptions and reductions granted to companies engaged in M&A activities, subject to specific conditions[17].

7. CONCLUSION

In India, mergers and acquisitions (M&A) play a big role in the business world and affect how shareholders are involved. As more companies join together, it shows that India is a promising place for both local and international investors. While these deals can bring benefits like growth and better competition, shareholders also face some risks. To protect them, there are strong rules like the Companies Act and SEBI regulations. These rules make sure that shareholders are treated fairly. By following these rules and being careful, companies can make mergers and acquisitions work well in India.

[15] Pratheek Pathak, Navita Nathani, Mergers and Acquisitions in India And Its Impact on Shareholders Wealth, 4(8) IRE Journals (2021).
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