



Motive, Benefit and Drawback of Merger and Amalgamation

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1. Introduction

Conventional thinking in the business world is driven by a spirit of competitiveness. In the business world we are not conditioned or schooled to think in terms of interdependence. Paradoxically, the success of our businesses typically depends on intricate cycles of processes, operations and functions coming together. In today's world, a merger or acquisition and demerger should typically translate to a larger pool of shared resources. Not only in economic terms but also in terms of cultural awareness, political know how and a broader knowledge pool in general. This, for the organization, ideally, should mean a strong competitive advantage, a bigger or stronger market share and a niche that they may not have enjoyed before. Ironically, what a large body of research indicates is that the opposite of this is what happens. Culture, Politics, Synergies and Leadership tend to be mismanaged and/or neglected more often than not and become the very weakness that end up bringing a merger or acquisition to a

screeching halt with an immense investment of resources wasted.

A merger or acquisition is a combination of two companies where one corporation is completely absorbed by another corporation. The less important company loses its identity and becomes part of the more important corporation, which retains its identity. A merger extinguishes the merged corporation, and the surviving corporation assumes all the rights, privileges, and liabilities of the merged corporation. A merger is not the same as a consolidation, in which two corporations lose their separate identities and unite to form a completely new corporation.

Federal and State laws regulate mergers and acquisitions. Regulation is based on the concern that mergers inevitably eliminate competition between the merging firms. This concern is most acute where the participants are direct rivals, because courts often presume that such arrangements are

more prone to restrict output and to increase prices.

The fear that mergers and acquisitions reduce competition has meant that the government carefully scrutinizes proposed mergers. On the other hand, since the 1980s, the federal government has become less aggressive in seeking the prevention of mergers. Despite concerns about a lessening of competition, U.S. law has left firms relatively free to buy or sell entire companies or specific parts of a company. Mergers and acquisitions often result in a number of social benefits. Mergers can bring better management or technical skill to bear on underused assets. They also can produce economies of scale and scope that reduce costs, improve quality, and increase output. They also can produce economies of scale and scope that reduce costs, improve quality, and increase output. The possibility of a takeover can discourage company managers from behaving in ways that fail to maximize profits. A merger can enable a business owner to sell the firm to someone who is already familiar with the industry and who would be in a better position to pay the highest price. The prospect of a lucrative sale induces entrepreneurs to form new firms. Finally, many mergers pose few risks

to competition. Antitrust merger law seeks to prohibit transactions whose probable anticompetitive consequences outweigh their likely benefits. The critical time for review usually is when the merger is first proposed. This requires enforcement agencies and courts to forecast market trends and future effects. Merger cases examine past events or periods to understand each merging party's position in its market and to predict the merger's competitive impact.

2. Motive behind Mergers of the Company

Synergies: This is the most common reason for a merger. It is expected that when two companies merge to form a new bigger company, the value of the new entity will be more than the combined value of two separate companies. Generally, there are two types of synergies that are aimed for:

Cost Synergies: Synergies that reduce costs through the economies of scale in various divisions of the company, viz. research and development, procurement, sales and marketing, manufacturing, distribution and general administration.

Revenue Synergies: Synergies that increase the overall revenue through expanded

markets, products cross-selling and increase in prices.

Economies of Scale: This generally refers to a method in which the average cost per unit is decreased through increased production.

Increased revenue/Increased Market Share: This motive assumes that the company will be absorbing and thus increase its to set prices.

Cross selling: For example, a bank buying a stock broker could then sell its banking products to the stock broker's customer, while the broker can sign up the bank's customers for brokerage account.

Rapid Growth: Generally, any company has two options to grow, viz. organic growth and external growth. Organic growth is achieved by increase in sales by making internal investments. External growth is achieved by increase in sales by buying external resources through mergers and acquisitions. Often, companies prefer to grow externally, especially the ones in a mature industry as the industry offers limited opportunities of growth. It is less risky to have external growth.

Market Power: A horizontal merger in a small industry will definitely help in increasing the market share. An increased market share will in turn give the power to influence prices. In fact, monopoly is an extreme example of horizontal merger. A vertical merger can also increase the market power by reducing the dependence on external supplier.

Unique Capabilities: Not every company can have all the resources or strengths required for a successful growth. There will come a time when the company wants to acquire the competencies and resources that it lacks. This can easily be done through mergers and acquisitions in a very cost effective way as compared to developing the capabilities internally.

Diversification: Diversification of the company's total cash flows is a reason argued by managers for the mergers. However, shareholders are not convinced by this reason as they can easily diversify their investments themselves at the portfolio level. This is cheaper and less painful than the company going through the process of merging with another company to achieve synergies created by diversification.

Bootstrapping EPS: A merger deal might have a bootstrapping effect on the company's EPS. This occurs when the acquiring company's shares are trading at a higher P/E ratio than the P/E of the target company and the P/E does not decrease even after the merger. Such an effect increases the current EPS of the company at the expense of decreased future EPS and decreased growth prospects.

Personal Incentives for Managers: The executives of a company might want the merger to satisfy their personal goals rather than maximize the shareholder value. A post-merger bigger company translates into more prestige and greater power for them. Even the compensation increases in a bigger company. Thus, the managers will prefer the merger to increase the size of their company.

Tax Issues: A company with a large taxable income will look at merging with a company with large carry forwards tax losses. By doing so, the acquiring company can lower the tax liability. A merger purely for reducing tax liabilities will not be approved by regulators; however, companies can hide this reason under other strong motivations to merge.

Unlocking Hidden value: A struggling company may be bought by an acquirer to unlock its hidden value. The acquiring company may believe that by making some improvements in management and organizational structure and adding more resources, it can make the company perform better. Of course, the acquirer will pay a lower price than the market price.

3. Benefits of Merger

Benefits of Mergers are manifold. Mergers can generate cost efficiency through economies of scale, can enhance the revenue through gain in market share and can even generate tax gains. The principal benefits from mergers and acquisitions can be listed as increased value generation, increase in cost efficiency and market share.

Benefits of Mergers are the main reasons for which the companies enter into these deals. Merger may generate tax gains, can increase revenue and can reduce the cost of capital. The main benefits of Merger are the following:

Greater Value Generation: - Mergers often lead to an increased value generation for the company. It is expected that the shareholder value of a firm after mergers or

acquisitions would be greater than the sum of the shareholder values of the parent companies. Merger generally succeeds in generating cost efficiency through the implementation of economies of scale. Merger also leads to tax gains and can even lead to a revenue enhancement through market share gain. Companies go for Mergers from the idea that, the joint company will be able to generate more value than the separate firms. When a company buys out another, it expects that the newly generated shareholder value will be higher than the value of the sum of the shares of the two separate companies. Mergers can prove to be really beneficial to the companies when they are weathering through the tough times. If the company which is suffering from various problems in the market and is not able to overcome the difficulties, it can go for a merger deal. If a company, which has a strong market presence, buys out the weak firm, then a more competitive and cost efficient company can be generated. Here, the target company benefits as it gets out of the difficult situation and after being acquired by the large firm, the joint company accumulates larger market share. This is because of these benefits that the small and less powerful firms agree to be acquired by the large firms.

Gaining Cost Efficiency: - When two companies come together by merger or acquisition, the joint company benefits in terms of cost efficiency. A merger or acquisition is able to create economies of scale which in turn generates cost efficiency. As the two firms form a new and bigger company, the production is done on a much larger scale firms form a new and bigger company, the production is done on a much larger scale and when the output production increases, there are strong chances that the cost of production per unit of output gets reduced. An increase in cost efficiency is affected through the procedure of mergers and acquisitions. This is because mergers and acquisitions lead to economies of scale. This in turn promotes cost efficiency. As the parent firms amalgamate to form a bigger new firm the scale of operations of the new firm increases. As output production rises there are chances that the cost per unit of production will come down.

Mergers and Acquisitions are also beneficial on certain points of aspects of various companies given below:

- When a firm wants to enter a new market

- When a firm wants to introduce new products through research and development
- When a firm wants achieve administrative benefits
- To increased market share
- To lower cost of operation and/or production
- To gain higher competitiveness
- For industry know how and positioning
- For Financial leveraging
- To improve profitability and EPS

4. Employee Benefits under Mergers

The Industrial Disputes Act, 1947 is the governing legislation that provides the machinery and procedure for the amicable settlement of conflicts between employer and employee. To determine whether or not an employee is a 'workman' within the meaning of this Act has always been a subject of constant controversy before the Courts in India. The reason being, when an employee is involved in a dispute with the employer or in a situation where his employment is terminated and such individual wants to avail the protective umbrella of the Act, the employer always contests by raising an objection that the employee is not a 'workman' within the

definition of the Act. At the time of any corporate deal or restructuring, the employees of a business entity do not automatically get transferred to the purchasing company and thus their grievances can be addressed only if they can be classified as a 'workman' before the eyes of law. As per Section 2(s) of the Act, a "workman" means any person (even including an apprentice) who is employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, regardless of whether the terms of employment are express or implied. For the purpose of any industrial dispute, the definition also includes any person who may be dismissed, discharged or retrenched in connection with, or as a consequence of, that dispute. It is important to note that this definition of "workman" does not include a person who may be employed primarily in a managerial or administrative capacity.

1. Compensation to Workman at the time of Transfer of Undertaking

Section 25FF of the Industrial Disputes Act, 1947 provides for Compensation to workmen in case of transfer of undertakings. Thus, for an

employee to get compensation under Section 25FF, three conditions need to be satisfied.

First, the workman's term of service should be uninterrupted. Second, the terms and conditions of service stipulated by transferee should be at par with the transferor. Third, the new employer should undertake to pay retrenchment compensation to the workmen on the basic premise that there was continuous service and the continuity was not hampered due to transfer of undertaking. Such provision has given rise to litigation wherein many conflicting judgments have been passed.

2. Transfer of Undertaking:

Procedure for Non-workman:- The rights for non-workmen in case of a transfer of an undertaking are governed by the terms and conditions of their employment contracts. If the Buyer refuses to employ them and the Seller does not wish to keep the employees, Seller will only have to provide them with their contractual termination entitlements. However, if the Buyer voluntarily decides to employ these employees, the employment agreements must be terminated and the selected employees hired by the Buyer, for which a procedure very similar to the one described above for workmen can be

followed (unless special contractual provisions apply). The main difference would be that the offer letter does not have to acknowledge seniority or to provide the same terms and conditions, although it is advisable to do so to ensure that the employees accept the offer.

Continuity of Service: - Most employees are entitled to earn such rights as vacations, pregnancy and parental leaves, termination and severance pay. However, they are not eligible to receive them until they have worked for an employer for a certain minimum time, which varies according to each kind of right. The continuity of employment provisions provide that a person's length of employment with the Seller of a business is attributed, or "flows through" to the purchaser of the business. This means that an employee's entitlements to rights that are based on length of the business. This means that an employee's entitlements to rights that are based on length of employment are unchanged, despite the scale of the business or the change in building service providers. When a person's length of employment is attributed to a new employer, the new employer has to recognize the time the person worked for the previous employer.

This “earned” time must be credited toward any rights the employee has that are based on his or her length of employment. Seller has to compensate the workmen if they are not employed by the Buyer or even when the Buyer does not allocate any work to them in another division. If the Buyer employs such employees on his own volition then such Buyer has to take into the account the seniority status enjoyed by the employee in the transferor.

Also, if the terms and conditions that govern the transferee company are more attuned to the employees’ interests than the transferor company, then in such a case protective termination provisions will not be invoked. The Industrial Disputes Act, 1947 provides for retrenchment compensation in cases of transfer or closure of undertaking.

Retrenchment Compensation

As regards for retrenchment compensation, the position which held the ground till Sunil Kr. Ghosh vs. K. Ram Chandran decided in November 2011 was that, in most of the mergers and acquisitions where there was a change of ownership or management of an industrial undertaking on a going concern basis and there was no variation in the terms of employment of the

workmen as part of the transaction, there was no requirement to obtain consent of workmen who did not wish to continue working under the new management. With Sunil Kr. Ghosh Case the position changed and now no workmen can be forced to work under a new management even when the terms of employment under the new management are no less favorable as those applicable prior to the transfer. The Apex Court in this case held: “It is settled law that without consent, workmen cannot be forced to work under different management and in that event, those workmen are entitled to retirement / retrenchment compensation in terms of the Act. In view of the same, we are of the view that the workmen are entitled to the benefit of such direction and it is the obligation on the part of the Management-Philips India Limited, to comply with the same.” This effect of this judgment is that, contrary to the judgments given by this Court earlier, the present case makes it mandatory for the Acquirers and Sellers in any merger or acquisition involving a change in management or ownership of an undertaking to take prior consent from workmen. In case such workman does not consent to such transfer, they will be entitled to retrenchment compensation in terms of Section 25F of the Act. Section 25F of the

Act provides for the amount of retrenchment compensation to be paid at the time of retrenchment. The compensation should be equivalent to fifteen days' average pay of the workman for every completed year of continuous service or any part thereof in excess of six months.

3. Legitimate Expectation of the Employees

The employees will have a legitimate expectation that the management will uphold their right and ensure they are benefitted during the transfer. In *Ram Praves Singh and Ors. Vs. State of Bihar and Ors.* This aspect of legitimate expectation was elaborately discussed. In the case the employees contended that their legitimate expectations that they would be employed in the firm after the transfer arose due to the following reasons:

A similar situation in the past where all private companies were taken over and their employees were absorbed; Whenever the undertaking of any company or institution was taken over by any statutory body or corporation like the current situation, the service of employees of such undertaking are also normally taken over; When an 'undertaking' is purchased, in the

absence of an intention to the contrary, all the assets and liabilities, as also the services of all employees are transferred to the purchaser and therefore the Board cannot refuse to absorb them.

All the employees of the society have crossed the maximum age limit for seeking fresh employment and if they were not absorbed by the Board, they will be deprived of their livelihood.

When the undertakings of such instrumentality of the state was taken over the another instrumentality of the State, 'fairness in action' which is one of the hallmarks of a 'State' (Article 12 of the Constitution of India) requires that the rights of the employees are protected by providing for their absorption in an appropriate manner.

The court thus held that, "a person can be said to have a 'legitimate expectation' of a particular treatment, if any representation or promise is made by an authority, their expressly or impliedly, or if the regular and consistent past practice of the authority gives room for such expectation in the normal course. Hence where this legitimate expectation persists

there is a need to meet such expectations and give effect to the rights of the employees”.

5. Drawbacks of Merger and Amalgamation

Merging two companies can provide the firms with synergies and economies of scale that can lead to greater efficiency and profitability, but it is important to note that mergers can have a downside, too. Mergers of a firm considering a merger should consider these potential disadvantages before going forward.

Culture Clash

When two companies merge, it is more than just the coming together of names or brands – it is the joining of two groups of people who bring along their own specific corporate cultures. If two firms have very different culture, conflicts can arise. For example, if an innovative, entrepreneurial company with a flat hierarchy were to merge with a highly hierarchical, conservative and traditional organization, the employees in the organization would be likely to have difficulties working together.

Leadership Issues

Cultural clashes can be exacerbated by discontent over leadership. Someone has to be in charge of the new company. If an executive from “Company A” takes the helm and does so with a leadership team made up of Company a people that may leave people from “Company B” feeling as if their company has been taken over rather than merged as an equal partner. That could lead to corporate infighting, a talent drain as people leave the company, or other negative effects.

Diseconomies of Scale

When businesses merge, it is often to achieve economies of scale. Larger organizations are typically able to produce goods and services more efficiently and at a lower per-unit cost than smaller businesses because fixed costs are spread out over a larger number of units. This is not always the case, however. Sometimes when two firms merge, being larger will actually create diseconomies of scale, where per unit production costs increase. For example, say two smaller manufacturers merge into a single large company. Economies of scale may arise from consolidating all manufacturing at one plant, eliminating the need for redundant workers and administrators and therefore reducing labor

costs. But now that one plant must distribute to a larger area, significantly increasing transportation costs a diseconomy of scale.

Consumer Perceptions

When two companies merge, they need to consider how consumers view the two firms and whether or not they view them in a compatible way. For example, if an environmentally friendly soap company were to merge with an industrial detergent manufacturer with a poor environmental track record, it may alienate the customers of the environmentally friendly soap company who don't want to support a company that is not environmentally responsible.

Layoffs

Merging two businesses is often a good method for reducing the labor force to the two organizations. For instance, a company may combine its two offices into one and reduce the number of staff performing the same duties. While this can provide cost savings for the company, it can also have a negative effect on employees. Employees may become fearful of losing their job and may lose their trust in the

organization. This can decrease employee motivation and reduce productivity.

Less Choice

A merger can lead to less choice for consumers.

Higher Prices

A merger can reduce competition and give the new firm monopoly power. With less competition and greater market share, the new firm can usually increase prices for consumers. For example, there is opposition to the merger between British Airways (parent group IAG) and BMI. (Link Guardian) This merger would give British Airways an even higher percentage of flights leaving Heathrow and therefore much scope for setting higher prices. Richard Branson (of Virgin) states:

“This takeover would take British flying back to the dark ages. BA has a track record of dominating routes, forcing less flying and higher prices. This move is clearly about knocking out the competition. The regulators cannot allow British Airways to sew up UK flying and squeeze the life out of the travelling public. It is vital that regulatory authorities, in the UK as well as

in Europe, give this merger the fullest possible scrutiny and ensure it is stopped.

Top Merger & Acquisition Deals in India to achieve different potential synergies in the market of competitive world

TATA STEEL-CORUS: Tata Steel is one of the biggest even Indian's steel company and the Corus is Europe's second largest steel company. In 2007, Tata Steel's takeover European steel Corus for the price of \$12.02 billion, making the Indian company, the world's fifth-largest steel producer. Tata Sponge iron, which was a low-cost steel producer in the fast developing region of the world and Corus, which was a high-value product manufacturer in the region of the world demanding value products. The acquisition was intended to give Tata steel access to the European markets and to achieve potential synergies in the areas of manufacturing, procurement, R&D, logistics, and back office operations.

Tata Steel has established by Indian Parsi Businessman Jamsetji Tata in 1907, exactly in the year when British American Tobacco (BAT) has started its first factory in India. But it started operating in the year 1912. Tata Steel holds a very vital place in

Indian business history, because it has introduced some of the unique concepts like 8-hour working days, leave with pay and pension system for the first time in India and the first player to start rapid industrialization process. In the later part the concepts invented and implemented by Tata became lawful and compulsory practice for the Indian employees. From Tata Steel, Tata has started investing in various other businesses like; oil mills, Airlines, Publishing, Motors, Consultancy services etc. in a short span of 30 years. In the year 1945 Tata entered into tea business by the name of Tata Tea, which was called as Tata Finlay earlier. Tata also entered into exports as Tata Exports, which is the most successful and the largest export house in India.

During the entire business in India Tata has seen many ups and downs, in different fields of business. The Indian Steel industry is regarded as the most important component for the development of nation, because steel industry (heavy industry) is considered as a very important and influential parameter for the development of any modern economy. The finished steel production in India has grown from 1.1 million tons in 1951 to 31.63 million tons in 2001-02, which can be regarded as the best

efforts to grow through different strategies
of merger and amalgamations.