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Corporate Mergers and Acquisitions: Legal, Accounting and Strategic Issues

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ABSTRACT

Mergers and Acquisitions have been widely used in developed economies as a growth strategy and is now increasingly getting accepted by Indian businesses as a critical tool of business strategy. Businesses are acquired to gain strengths, expand customer base, cut competition or enter into a new market or product segment. The basic argument that M&As increase shareholders value through exploitation of synergies is based on the assumption that the combined organization can be operated in a way that generates greater value than would be the sum of the value generated by the "stand-alone" companies.

Keywords :

Introduction

The core goal of the any corporate is to maximize its wealth and shareholder's value. This objective can be achieved internally either through the process of introducing new products or by enlarging the capacity of the existing products. On the other hand, the growth process can be facilitated externally by acquisitions, takeovers, mergers and so on. There are strengths and weaknesses of both the processes of achieving goals. This study seeks to examine the legal and accounting issues in general and business strategy issues in merger and acquisition proposal of BSNL and MTNL.

Mergers, Acquisitions and Takeovers: Meaning and Types

Mergers, Acquisitions and Takeovers etc. are terms that are commonly used interchangeably but often differ by situation. Merger generally refers to unification of two equal players into one unit, while Acquisition refers to one competitor buying out another to combine the bought entity with itself. A takeover may be defined as obtaining of control over management of a company by another. A company may have effective control over another company by holding minority ownership. As per Accounting Standard 14 which is for the purpose of amalgamations and mergers, the exhaustive classification of these terms is provided as:

* Transfer of all the assets and liabilities from the transferor to the transferee,
* Acceptance of shareholding in the transferee company by at least 90% of the shareholders of the transferor by exchange of equity shares,
* Intention to carry on the transferor's business after amalgamation and
* Non-adjustment in the value of assets and liabilities other than to ensure uniform accounting policies.

Notwithstanding terminological differences, mergers can be usefully distinguished in to three kinds (i) Horizontal Merger takes place when two or more corporate firms dealing in comparable lines of activity combine together due to variety of reasons such as reduction in competition, putting an end to price cutting and to get the advantages of economies of scale in production, research and development and marketing and management. Oriental Bank of Commerce and Global Trust Bank merger is an example of this type while BSNL and MTNL, if merged, shall also come under this category. (ii) Vertical Merger is a grouping of two or more corporate firms involved in different stages of production or distribution. When electronic goods manufacturing company and electronic goods marketing company merged with each other, this will include this type. This kind of merger may take the form of forward or backward merger. If a company combines with the supplier of material it is known as backward merger and vice versa that is if it combines with the customer it is called forward merger. (iii) Conglomerate merger is a combination of corporate firms engaged in unmatched and unrelated lines of business activity. Diversification of risk constitutes the rationale for such kind of mergers. The mergers of L& T and Voltas Ltd. is the model of conglomerate companies.

Legal Framework and SEBI 's Role

The beginning to amalgamation may be made through common agreements between the transferor and the transferee but plain agreement does not provide a legal cover to the transaction unless it carries the sanction of company court for which the procedure laid down under section 391 of the Companies Act. Procedure for merger and amalgamation is different from takeover. Formers are regulated under the provisions of the Companies Act, 1956 whereas takeovers are regulated under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations.

(A) THE COMPANIES ACT, 1956

The following is the outline of legal procedures for merger or acquisition laid down in the said Act-

- Two or more companies can only be amalgamated if memorandum of association of such companies is permitted to do so. In the absence of this, permission of the shareholders, board of directors and the Company Law Board should be taken before affecting the merger.
- Both the companies should inform the stock exchanges where they are listed about the merger.
- The board of directors (BOD) of the individual companies should approve the draft proposal of mergers.
- A copy of draft proposal approved by the BOD of both the companies should be submitted to high court. High Court would convene a meeting of shareholders and creditors to approve the mergers but the notice of such meeting should be sent to them at least 21 days in advance.
- The individual companies should hold the meeting and at least, 75% of shareholders and creditors should approve the scheme.

- After the approval of shareholders and creditors, on the petitions of the companies the high court will pass order to sanction the merger scheme.
- The true copies of high court's order will be submitted to the Registrar of Companies.
- Transfer of assets and liabilities of acquired company will take place as per approved scheme and
- As per scheme the acquiring company will exchange share or debentures or cash for the shares and debentures of the acquired company.

(B) SEBI GUIDELINES
Securities Exchange Board of India (SEBI) has provided guidelines for takeover only. The prominent features of the guidelines are:

(i) When an individual or a company acquires five per cent or more of the voting capital of a company then Target Company and the concern stock exchange shall be notified immediately.

(ii) There is a limit in acquiring shares of another company without making any offer to other shareholders that is ten per cent of the voting capital.

(iii) If the holding of the acquiring company exceeds ten per cent, a public offer to purchase a minimum of twenty per cent of the shares shall be made to the remaining shareholders by a public announcement.

(iv) If offer is made to the shareholders the minimum offer price shall not be less than the average of the weekly high and low of the closing prices during the last six months before the date of announcement of such offer.

(v) The offer should disclose the detailed terms of the offer, identity of the offerer, details of the offerer's existing holdings in the offeree company etc. and this information should be made available to all the shareholders at the same time and in the same mode.

The main objective of the Companies Act and the SEBI guidelines for takeovers are to ensure full disclosure about the mergers and takeovers and to protect the interests of the shareholder especially the small shareholders.

Accounting Issues
Mergers and Acquisitions involve complex accounting behavior. There are two major accounting treatments which are available in case of mergers and acquisitions. Firstly, Pooling of interest method of accounting – under this method the financial statements that is the balance sheet and the profit and loss account of merged corporates are combined without recording the effects of merger in the financial statements. This indicates those assets, liabilities and other items of the acquiring and the acquired corporates are simply added at the book values without any adjustments for mergers. Therefore, there is no revaluation of assets or creation of goodwill or capital reserve at the time of mergers. Second method is Purchase method- under this method the assets and liabilities of acquiring company after the acquisition of the target company are adjusted for the purchase price paid to the target company. The purchase price can be considered in shares, debentures or cash or a combination of all these items as per agreement. The assets and liabilities after merger are revalued to know the monetary value of such assets and liabilities at the time of merger. If the acquirer pays a price which exceeds the fair market value of assets and liabilities the excess amount will be shown as goodwill in the acquiring company's books. On the other hand, if the fair market value of assets and liabilities is less than the purchase price paid then this difference will be recorded in liabilities side as capital reserve.

Strategic Issues: BSNL AND MTNL
Mergers and Acquisitions have been widely used in developed economies as a growth strategy and is now increasingly getting accepted by Indian businesses as a critical tool of business strategy. The strategic issues may include Instantaneous growth, increased market share, acquisition of a competence, access to funds and tax benefits.

A core group set up by the department of Telecommunication (DOT) on; the restructuring of public sector telecom companies has recommended the merger between BSNL and MTNL. The core group which submitted its report to the secretary of DOT has said that the merger of the two entities is necessary in view of the new competitive environment in the telecom sector in the country. The merged entity will become the largest company in both in wire line and mobile operations. The committee has explored the pros and cons of the four feasible options for mergers of the two public sector entities-(i) BSNL merger into MTNL, (ii) MTNL into BSNL,(iii) acquisition of BSNL by MTNL and (iv)acquisition of MTNL by BSNL.It has suggested that the BSNL merger into MTNL would involve a lot of stamp duty costs and may violate SEBI norms envisaging a minimum public float for the listed company. The other option is MTNL may be merged into BSNL; the relisting of the company would be required. The other option is acquisition of BSNL by MTNL. This would be acceptable to the MTNL shareholder but trade unions may resist this move. MTNL is a listing a company in India and New York Stock Exchange. The final option is acquisition of MTNL by BSNL if this happens the listing company's shareholders especially the minority shareholders will not be benefited. Now that it is almost certain that the two would not be disinvested in the near future, a merger is the best available option. The original proposal was to disinvest MTNL. Later, the idea of a merger was put forward.

Conclusion
There are two ways to grow a business one is through organic growth and other one is through inorganic growth. While taking the organic growth path the company incrementally grows its people, customers, infrastructure resources and thus revenues and finally profits while inorganic growth would provide instantaneous growth enabling the company to skip a few steps on the growth ladder. Mergers and Acquisitions is an inorganic growth strategy. There are legal boundaries on mergers and acquisitions in India under Companies Act, 1956 and SEBI. Accounting Standard has also play a crucial role in determining the purchase price and its accounting treatment.