CORPORATE RESTRUCTURING THROUGH MERGERS AND ACQUISITIONS: AN INDIAN PERSPECTIVE

Dr. Sandeep Bansal*

ABSTRACT

In the era of liberalization and globalization, any corporate, in order to survive, has to operate and compete successfully both with the domestic and multinational competitors. If a company fails in this regard, the market forces will, sooner or later, compel it to exit the market. Corporate Restructuring has become an important means for achieving such changes in India and else where. Corporate Restructuring is an integral part of present economic paradigm. Mergers, takeovers, restructuring and corporate control issue have become central public and corporate policy issue. The study is an attempt to find out the motivating factors for companies to go for Mergers and Acquisitions The present study also measure pre merger and post merger performance of the companies based on accounting data. We find that merger of HLL with BBLIL enhanced the revenue of the merged company. It can be inferred that merger of the company gives real benefits to the merged companies.

Key words: *corporate restructuring, mergers, acquisitions, operating synergy, financial synergy*

* Assistant Professor, I.G.N. College, Ladwa, Kurukshetra.

INTRODUCTION

In the era of liberalization and globalization, any corporate, in order to survive, has to operate and compete successfully both with the domestic and multinational competitors. If a company fails in this regard, the market forces will, sooner or later, compel it to exit the market. Corporate Restructuring has become an important means for achieving such changes in India and else where.While planning for mergers and acquisitions management expects synergies both financial as well as operating in different manner. But in reality is the management successful to generate that potential synergy or not is the important topic. The aim of this paper is to find out whether the claims made by management while opting for Mergers and Acquisitions to generate synergy are achieved or not.

Corporate Restructuring is defined as "comprehensive process, by which a company can consolidate its business operations and strengthen its position for achieving its position for achieving its short term as well as long term corporate objectives – synergistic, dynamic, continuing as a competitive and successful entity." Such changes can, however, vary greatly depending on choices made as to what to change, in what way and how much.

"Corporate Restructuring is the process of changing organization structure of the group company/companies to make it more useful in achieving goals. The process of restructuring may involve regrouping companies of the same group or regrouping the various departments or divisions or merging some companies / divisions and/or building some new ones or it may also include delaying within existing organization."

Mergers, takeovers, divestitures, spin offs, and so on, referred to collectively as Corporate Restructuring, have become a major force in the financial and economic environment all over the world. Mergers and Acquisitions are century old phenomenon for corporate survival or death.

Mergers refer to a fusion between two or more firms that involves the integration of their operations with a view to bring in certain operational efficiencies. The assets and liabilities of the merging companies get transferred to the merged (combined) company.

Classifications of mergers

- **Horizontal mergers:** These types of mergers take place when the two merging companies produce similar product in the same industry. e.g. HP and Compaq.
- **Vertical mergers:** These types of mergers occur when two firms, each working at different stages in the production of the same good, combine.

Backward Merger: Here the company may merge with its supplier of inputs. e.g. coca cola integrated vertically backward when it bought its franchise and bottlers.

Forward Merger: Here the company may merge with its customer, dealer and distributor. e.g. Reliance petroleum could integrate forward if it decides to sell its entire output through its own petrol pumps instead of through Indian oil.

- **Conglomerate mergers:** A conglomerate is a firm that has external growth through a number of mergers of companies whose business was not related either vertically or horizontally. e.g. Reliance Industries Ltd. merged with Reliance Petroleum Ltd, ICICI merged with ICICI Bank.[4]

Acquisition may be defined as an act of acquiring effective control by one company over assets and management of another company without any physical combination of their businesses.[3]

In a friendly acquisition, the controlling group sells its controlling shares to another group of its own accord. The acquiring firm makes a financial proposal to target firm's management and board.

In a hostile takeover an outside group launches a hostile attack to take over the control of the company with the concurrence of the existing controlling group. This is done by means of an open offer to share holders of the target company.[5]

OBJECTIVES OF THE STUDY

1. To study the motivating factors focusing companies to go for Mergers and Acquisitions.
2. To study to what extent, mergers and acquisitions have resulted in improving the financial performance. For this purpose, financial performance of pre and post (M & A) period is measured, analyzed and compared ion selected cases.
3. To study the outcome of mergers and acquisitions i.e. to measure the impact of mergers and acquisitions on the companies performance including its impact on shareholders.
4. To draw certain findings and make suggestions.

Motivational Factors Compelling Companies to Go for M & A

Financial Synergy occurs as a result of the lower costs of internal financing vs external financing. A combination of firms with different cash flow positions and investment opportunities may produce a financial synergy effect and achieves lower cost of capital. When the two firms merge, their combined debt capacity may be greater than the sum of their individual capacities before the merger. Also when the cash flow rate of the acquiring company

is greater than that of the acquired company, capital is relocated to the acquired firm and its investment opportunities improve.6 There are many ways in which a merger can result in to financial synergy and benefits:

- Eliminating the financial constraint
- Deploying surplus cash
- Enhancing debt capacity
- Lowering the financial cost

Unilever Merger: Hindustan Lever merged with group company Brooke Bond Lepton India Ltd. (BBLIL). As levers has huge finds like turnover of Rs. 3367 crore and net profits of 239 croer, reserves of Rs. 670 crore and BBLIL was operating in a business where margins low and was in need of more influx of funds. The merger thus unlocked lever's vaults, allowing surplus funds parked in its accounts to be used for generating new businesses on the former BBL's behalf.

Table

	HLL	BBLIL	HLL-BBLIL
Sales	3366.94	2073.98	5440.92
Net Profit	239.22	126.46	365.68
PBT	392..36	177.13	569.49
Equity Capital	145.84	120.48	199.40
Reserves	670.00	291.91	961.91
Net Worth	815.84	412.39	1161.31
Debt	160.20	239.22	399.42
Debt : Equity	0.19	0.58	0.34
Book Value	55.89	34.25	58.22
EPS (Rs.)	13.03	10.49	18.43
Share price (Rs.)	800.00	322.00	--
P/E Ratio	48.80	30.69	--

Figures in Rs. Crore, year ended December 1995.

Source: Sheeba. Kapil, Kanwal Narayan Kapil; Financial Management – Strategy implementation and control. pp 930

HLL merged with BBLIL. The outcome of this restructuring is that the debt capacity of HLL has been improved. The debt equity ratio of merged (HLL-BBLIL) is 0.34, which indicates that

merger enhanced the capacity of new entity to service a large amount of debt. The increased borrowing allows a higher interest tax shield which adds to the shareholder's wealth. Earlier the net worth of HLL was 815.84 and of BBLIL were 412.39. But net worth of new firm is 1161.31. Which clearly indicates that Mergers add to the shareholders wealth? The above table also shows that earlier profits of BBLIL were 126.46, but merger has improved the profitability of the merged firm. So it is very clear that HLL had a turnover of Rs. 3366.94 crores and net profit of Rs. 239.22 crores, and reserves of Rs. 670 crores and on the other hand, BBLIL was operating in a business where their margins were low and was in need of more injunctions of funds. The merger thus unlocked the lever's vault, allowing surplus funds parked in its accounts to be used for generating new businesses on the behalf of old firm. In this way BBLIL got rid of the financial constraints and HLL have got enough internal opportunity to invest its surplus.

Operating Synergy occurs as a result of economies of scale, some degree of monopoly (or monopsony) power, or increased managerial efficiencies. The value may be achieved by increasing sales volume in relation to assets employed (operating asset turnover), increasing profit margins.[7] Operating economies of scale are achieved through horizontal, vertical and conglomerate mergers. Operating economies occur due to indivisibilities of resources like people, equipment and overhead.

- **Economy of scale**
- **Operating economy**
- **Synergy**

SCL-TSL Merger: Sundaram Clayton Ltd. (SCL) merges with TVS- Suzuki Ltd. (TSL). By this merger TSL became the second largest producer of two wheelers after Bajaj. The main motivation of the take over was TSL's need to tide over its different market situation through increased volume of production. It needed a large manufacturing base to reduce its production cost. Large amount of funds would have required for creating additional production capacity. SC L also needed to upgrade its technology. SCL's and TSL's plants were closely related which add to their advantage. The combined company as also been enabled to share the common R&D facilities.

Differential Efficiency occurs when management of company A is more efficient than the management of company B and if, after company A acquires company B, the efficiency of company B is brought up to the level of company A, then this increase in efficiency is attributed

to the merger. Some companies operate below their potential and consequently have low efficiency. Such companies are likely to be acquired by the other, more efficient companies in the same industry. The acquiring company would also have the managerial ability to improve acquired company.

Diversification: Merging of two companies belonging to unrelated industries (conglomerate merger) cuts down the element of cyclicality, if any, in their business. Such a combination of unrelated (diversified) business that have negatively correlated income stream protects the existing business of the acquiring/merged company. The combination of management and other resources increase the immunity of the company to withstand and overcome the crises situation.

RPG – ICIM Merger: RPG enterprises took over ICIM and Harrisons Malayalam Ltd. RPG has decided to enter or expand in electronics industry rather than dependence on internal expansion. It offered them a special timing advantage and has provided an easy access to the electronics industry.

Tax Benefit: Merging with firms having accumulated losses and unabsorbed depreciation in their financial statements allow the merged firm to set off this unabsorbed depreciation and accumulated losses against the post merger profits of the merged firm. The provisions are given u/s 72A and 72AA of the Indian Income Tax Act, 1961.

ACML – Arbind Mills Merger: ACML was closed on account of labor problems. At that time they had an accumulated loss of Rs. 3.34 crores. Arbind Mills saved about Rs. 2 crore in tax liability for the next two years after the merger because it could set-off ACML's accumulated loss against its profits.

MERGERS AND ACQUISITIONS TRENDS IN INDIA

Liberalization has caused increased competitive pressure leading to structural changes of Indian industries. The first M&A wave in India took place towards the end of 1990's. But it is continuously moving upwards.

Mergers and acquisitions are the dominant feature of corporate restructuring activity in India, similar to the most of the developed countries.

Share of Mergers and Acquisitions in India

Year	M&A	Mergers	%
1998-99	292	80	27.4
1999-00	765	193	25.2
2000-01	1177	327	27.8
2001-02	1045	323	30.9
2002-03	838	381	45.5
2003-04	834	834	34.1

The mergers and acquisitions scenario is hotting up in India. Mergers and Acquisitions are not new to Indian situation, but they were very low key affairs. Mergers and Acquisitions wave resulted in a large number of Mergers and Acquisitions. Mergers and acquisitions in India are continuously on the rise. Volumes of mergers and acquisitions are expected to grow two fold from 2006 and four times as compared to 2005. But share of acquisitions is greater as compared to mergers.

CONCLUSION

In real terms, the rationale behind mergers and acquisitions is that the two companies are more valuable, profitable than individual companies and that the shareholder value is also over and above that of the sum of the two companies. This study is an attempt to measure pre merger and post merger performance of the companies based on accounting data. We find that merger of HLL with BBLIL enhanced the revenue of the merged company. It can be inferred that merger of the company gives real benefits to the merged companies. The present study is also aimed to find out the impact of merger on the profitability of the resulting company. From the above analysis it can be said that the profitability of resulting companies are increased.

REFERENCES:

1. Malik K. Amit and RakshitDabdas (2006): Corporate Restructuring through Demergers: A case study, Journal of Finance India (December) Vol. XX No. 4 pp 1321-1338
2. P. Mohana Rao editor (2000): Mergers and acquisitions of companies, pp 48.
3. Rajiv Srivastava and Anil Mishra (2009): Financial Management. pp 376-377.
4. Sheeba Kapil and Kanwal Narayan (2003): Financial Management- Strategy implementation and control. pp 930.
5. B. K. Swain (2000): Mergers and Acquisitions of the companies. pp 123.
6. Study material published by CDLU, Sirsa.

7. V. K. Bhalla (2009): Financial Management and Policy – Text and Cases. pp 984
8. Sisodiya Amit Singh (2004): Mergers and Demergers: Concept and Cases ICFAI University Press pp 151-160.
9. Ramanujam S (2007): Mergers at al, New Delhi Tata McGraw Hill Publishing Co. ltd.
10. I M Pandey (2005): Financial Management. Pp 682.
11. Ghosh, T. P. (1999): Economic value added TM; A Tool for Business Planning.
12. Journal of Financial economics, 49, pp 283-306