

## **1.1 Introduction :**

Business organizations are not islands in themselves. They are part of the society in which they operate and they are affected by the internal and external environment. In the modern world, business of any type and size is affected by the government policies, programs, rules and regulations etc. Business policy and strategy decisions are designed in the realm of overall government policy and system environment.

With increasing industrialization and frequent entry of new players, markets become more and more competitive and dynamic and the changing economic environment creates its own compulsions. As a result pressure builds up on the existing players to maintain their market share and profit margins. This leads us to the fact that growth is vital for a business firm's survival. Growth can be achieved in either of the two ways: internal or external expansion. While internal expansion takes place by building new capacities or utilizing the existing ones within the organization, external expansion takes place through Mergers and Acquisitions (M&A).

Mergers and acquisitions provide a shortcut to corporate growth. M&As may be critical to the healthy expansion of business firms as they evolve through successive stages of growth and development. Successful entry into new geographical markets by a firm may require M&A at some stages of firm's growth. Even though the strategy of M&A provides some quick benefits, if not implemented properly it can create some problems as well.

## **1.2 M&A (Definitions)**

When different companies combine together into new corporate organizations with the objective of wealth maximization, such a process is known with varying names such as mergers, acquisitions, takeovers, amalgamations etc. Strictly speaking mergers take place when two or more companies of equal size and strength formally submerge their corporate identity into a single one in a friendly atmosphere.

Acquisitions (take-overs) take place when a company offers cash or securities in exchange for the majority shares of another company with management control.

Broadly, there are following types of mergers found in the Indian scenario.

1. **Horizontal mergers:** this involves two firms both acquiring firm and the target firm belonging to the same industry which are at the same stage of industrial process. These mergers are carried out to obtain economies of scale in production, broadening the product line, reducing working capital requirements increasing market shares etc.
2. **Vertical mergers:** this involves two or more firms involved at different stages of production in order to ensure backward or forward integration wherein one of the firms becomes part of supply chain towards market outlets. The acquirer firm gains a strong position due to reduction working capital and inventories. The acquirer company gains a strong position due to the imperfect market of its intermediately products and also through control over product specifications. However these gains must be weighed against the adverse effects of the merger. For instance, firms which have monopoly power in one stage may increase barriers to entry through vertical integration and this would help to discriminate between different purchasers by monopolization of raw material supplies or distributive outlets.
3. **Conglomerate mergers:** this involves two or more firms involved in diversified business merge to reduce risks by diversification and utilization of financial resources. It enhances the overall stability of the acquirer company and improves the balance in the company's total portfolio of diverse products and production processes. Through this process, the acquired firm gets access to the existing productive resources of the conglomerate which result in technical efficiency and furthermore it can have access to the greater financial strength of the present acquirer which provides a financial basis for further expansion by acquiring potential competitors. These processes also lead to changes in the structure and behavior of the acquired industries since it opens up new possibilities.

4. Reverse mergers: this involves sick firms merging with their parent firm usually for tax savings advantage to avail benefits of carrying forward losses of sick company.

### **1.3 Merger Procedure:**

The actual procedure to be adopted during the merger process is as under:

- (i) Adequate provisions must be there in Memorandum of Association and Articles of Association of both the acquirer and acquired Companies.
- (ii) Approval under section 23 of MRTP Act 1969 is not required however compliance of Section 29 of FERA 1973 is required in case of transfer of shares involving foreign nationals or NRIs
- (iii) Acquirer Company has to prepare a scheme of amalgamation under Section of the Companies Act 1956. The draft scheme has to be agreed by the offeree company and submitted to High Court.
- (iv) Both Companies Board of Directors should approve the scheme and authorize the Directors to make an application to the High Court under section 391 of the Companies Act, 1956.
- (v) The proposed merger should be informed to the regional stock exchange where registered office of listed companies involved in the merger are located and to call all other stock exchanges where shares of these companies are listed.
- (vi) A press release should be made by both the companies of their decision.
- (vii) The acquiring company has to apply to financial institutions and banks who have advanced funds to their projects for their approval.

- (viii) Both the companies have to make an application under section 391 of Companies Act, 1956 and Company (Court) Rules, 1959 for an order by judges' summon convening the meeting of members of two companies to approve the scheme. The copy of the order is to be filed with the Registrar of the Companies.
- (ix) Notice of the meeting in prescribed form No. 36 are to be printed and advertised in the newspaper twenty one days before the day of meeting.
- (x) The separate meetings of equity shareholders, preference shareholders and creditors for their approval are to be held. The reports are to be submitted to the High Court within seven days of holding of these meetings.
- (xi) The acquirer company has to submit an application to the prescribed authority in case benefits of section 72A of Income Tax Act, 1961 are to be availed.
- (xii) The petition and affidavit have to be submitted to the High Court for confirmation.
- (xiii) The copy of order is to be filed with the Registrar of Companies (ROC) within thirty days of passing of orders by the court.

#### **1.4 Scheme of Merger:**

The scheme of any arrangement or proposal for a merger is the heart of the process and has to be drafted with care, There is no specific form prescribed for the scheme. It is designed to suit the terms and conditions relevant to the proposal but it should generally contain the following information as per the requirement of section 394 of the Companies Act, 1956.

- a) Particulars about transferor and transferee Companies
- b) Appointed date of merger

- c) Terms of transfer of Assets and Liabilities from transferor company to transferee Company
- d) Effective date when scheme will come into effect.
- e) Treatment of specified properties or rights of Transferor Company.
- f) Terms and conditions of carrying business by Transferor Company between appointed date and effective date.
- g) Share capital of Transferor Company and Transferee Company specifying authorized, issued, subscribed and paid up capital.
- h) Proposed share exchange ratio, any condition attached thereto and the fractional share certificates to be issued.
- i) Issue of shares by transferee Company.
- j) Transferor companies' staff, workmen, employees and status of Provident Fund, Gratuity Fund, Superannuation Fund or any other special funds created for the purpose of employees.
- k) Miscellaneous provisions covering income tax dues, contingent and other accounting entries requiring special treatment.
- l) Continuation of legal proceedings of Transferor Company by the transferee company after the effective date.
- m) Effect of amalgamation on contracts of Transferor Company after the effective date.
- n) Commitment of transferor and Transferee Company towards making an application under sections 391 and 394 and other applicable provisions of Companies Act, 1956 to their respective High Courts.
- o) Enhancement of borrowing limits of Transferee Company upon scheme coming into effect.
- p) Transferor and transferee Company's consent to make changes in the scheme as ordered by the court or other authorities under law and exercising the powers on behalf of the companies by their respective boards.
- q) Description of power of delegates of Transferee Company to give effect to the

scheme. Qualifications attached to the scheme which require approval of different agencies.

- r) Effect of non-receipt of approvals / sanctions etc.
- s) Treatment of expenses connected with the scheme.
- t) Dissolution of Transferor Company (without winding up) on the effective date.

### **1.5 Valuation in Merger: Determination of Share Exchange Ratio:**

An important aspect of Merger procedure relates to valuation of business in order to determine share exchange ratio in mergers. Valuation is the means to assess the worth of a company which is subject to merger or takeover so that consideration amount can be quantified and the price of one company for other can be fixed, Valuation of both companies subject to business combination is required for fixing the consideration amount to be paid in the form of exchange of shares. Such valuation helps in determining the value of share of acquired company as well as acquiring company to safeguard the interest of shareholders of both the companies.

Broadly, there are three methods used for valuation of business depending upon the main premise of which the specific valuation model is based.

#### **(i) Net Asset Value (NAV) Method:**

Net Asset Value is the sum of total of Assets (fixed assets, current assets investments on date of balance sheet less all debts, borrowings and liabilities including both current and likely contingent liability and preference share capital). Deductions will have to be made for arrears of preference dividend, arrears of depreciation, etc. However, there is may be some modifications in this method and fixed assets may be taken at current realizable value, (especially investments and real estate etc.) replacement cost (plant and machinery) or scrap value (obsolete machinery). The Net Asset Values, so arrived is divided b fully diluted equity (after considering equity increases n account of warrant conversion etc.) to get NAV per share.

The three steps necessary for valuing shares are:

- Valuation of Assets
- Ascertainment of Liabilities
- Fixation of the value of different types of equity shares

**(ii) Yield Value Method:**

This method also called profit earning capacity method is based on the assessment of future maintainable earnings of the business. While the past financial performance serves as guide, it is the future maintainable profits that have to be considered. Earning of the company for net few years are projected ( by valuation experts) and simple or weightage average of these profits is computed. These net profits are divided by appropriate capitalization rate to get true value of the business. This figure divided by equity value gives value per share. While determining operating profits of the business, it must be valued on independent basis without considering benefits on accounting of merger. Also, past or future profits need to be adjusted for extra ordinary income or loss not likely recur in future. While determining capitalization rate, due regard has to be given to inherent risk attributable to each business. Thus, a business with established brands and excellent track record of growth and diverse portfolio will get a lower capitalization rate and consequently higher valuation whereas a cyclical business or a business dependent on seasonal factors will get a higher capitalization rate. Profits of both companies should be determined after ensuring that similar policies are used in various areas like depreciation stock valuation etc.

**(iii) Market Value Method:**

This method is applicable only in case where shares of companies are listed on a recognized stock exchange. The average of high or low values and closing prices over a specified previous period is taken to be representative value per share.

## **1.6 Theories and motives of M&A**

Following three theories can be attributed as the theories of M&A:

1. When M&As are driven by the quest for synergies in operational, financial, distributional and R&D activities, it's called the efficiency theory of mergers
2. When M&As are driven by the quest for sharing organizational resources, it's called the resource dependence theory of mergers to reduce competition in Horizontal mergers, to reduce interdependence between the buyers and sellers in vertical mergers and to address dependence on other's organizational resources in conglomerate mergers.
3. When M&As are driven by the managerial desire for power and higher salary, it's called the agency theory.

Following categories can be attributed to motives of M&As:

- Improved efficiency of operations
- Increased market share
- Operating synergy
- Financial synergy
- Tax saving motives
- Risk reduction by diversification
- Enhancing promoter's stake, Gaining managerial expertise acquiring a new product or brand name etc. are some other motives of M&As.

## **1.7 Importance of Petroleum industry in Indian economy:**

The Indian petroleum industry is one of the oldest ones in the world with oil being discovered in Assam in 1867. With a demand for 120 million tons per annum India is the fourth largest oil consumption zone in Asia and oil consumption is expected to grow to 250 million tons per annum by 2024-25. Significance of the petroleum industry in India springs from the fact that it accounts for about 10% of GDP and oil

sector contributes approximately 30% of revenues collected by the Govt. from excise and customs duties.

India's targeted economic growth rate of 7-8% would generate an increase in energy demand of an equal magnitude and oil and energy sector will be the single biggest beneficiary. According to CLSA Asia Pacific, with more than a billion people, full deregulation of a 100 million ton market growing at twice the world averages India represents one of the most exciting oil sectors in the world today.

Over the last few years, the sector has been opened up. The Petroleum Regulatory Bill envisages the institution of regulator, which will oversee the downstream aspects of the sector. A major trend in the oil and gas regulation in India is the opening up of this sector to private and foreign investments. 100% FDI is allowed in exploration, pipeline infrastructure, refining and in downstream retailing.

### **1.8 Policy Changes Introduced by Govt. of India in Petroleum Sector in the past:**

In view of the widening gap between the demand and supply of oil & gas in the country, Govt. of India has taken several policy initiatives to facilitate the increase of production of petroleum products in the country.

Several policy changes in the upstream oil sector have been introduced such as:

- (i) Encouragement of participation of private sector Indian and foreign companies in oil exploration and production through New Exploration Licensing Policy.
- (ii) Opening of coal bed methane sector to private sector.
- (iii) Encouraging Indian oil companies to acquire equity oil abroad.

Policy changes brought about in downstream oil sector of oil refining and marketing:

- (i) Oil refining sector has been de-licensed.
- (ii) Pricing mechanism of petroleum products has been changed from Administered Pricing Mechanism (APM) to Market Driven Pricing Mechanism.
- (iii) Parallel marketing of petroleum products by private sector companies has been introduced.
- (iv) Promotion of CNG and LPG as auto fuels
- (v) Import of LNG etc.

Thus along with the economic liberalization in Indian economy in general, Govt. of India has completely liberalized the petroleum sector for competition and this has unleashed a great amount of driving forces and causing a lot of churning in this sector. Consequently petroleum sector in India is undergoing massive corporate restructuring parallel to other sectors in Indian economy during the past few years. The present study is an attempt to understand this process of change.

