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A Study on the Effects of Mergers & Acquisition on the Performance of Company

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Introduction

We have been learning about the companies coming together to from another company and companies taking over the existing companies to expand their business.

With recession taking toll of many Indian businesses and the feeling of insecurity surging over our businessmen, it is not surprising when we hear about the immense numbers of corporate restructurings taking place, especially in the last couple of years. Several companies have been taken over and several have undergone internal restructuring, whereas certain companies in the same field of business have found it beneficial to merge together into one company [1].

In this context, it would be essential for us to understand what corporate restructuring and mergers are all about.

All our daily newspapers are filled with cases of mergers, acquisitions, spin-offs, tender offers, & other forms of corporate restructuring. Thus important issues both for business decision and public policy formulation have been raised. No firm is regarded safe from a takeover possibility. On the more positive side Mergers may be critical for the healthy expansion and growth of the firm. Successful entry into new product and geographical markets may require Mergers at some stage in the firm's development. Successful competition in international markets may depend on capabilities obtained in a timely and efficient fashion through Mergers. Many have argued that mergers increase value and efficiency and move resources to their highest and best uses, thereby increasing shareholder value.

To opt for a merger or not is a complex affair, especially in terms of the technicalities involved. We have discussed almost all factors that the management may have to look into before going for merger. Considerable amount of brainstorming would be required by the managements to reach a conclusion. e.g. a due diligence report would clearly identify the status of the company in respect of the financial position along with the net worth and pending legal matters and details about various contingent liabilities. Decision has to be taken after having discussed the pros & cons of the proposed merger & the impact of the same on the business, administrative costs benefits, addition to shareholders' value, tax implications including stamp duty and last but not the least also on the employees of the Transferor or Transferee Company [1].

Corporate restructuring refers to a broad array of activities that expands or contracts a firms operation or substantially modify its financial structure or bring about a significant change in its organizational structure and internal functioning. It includes mergers, takeovers, acquisitions, slump sales, demergers etc.

Mergers, acquisitions and restructuring have become a major force in the financial and economic environment all over the world. Essentially an American phenomenon till mid-1970s, they have become a dominant global business theme since then.

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Mergers

A merger 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.

Merger Law Definition

1. In contract law, the action of superceding all prior written or oral agreements on the same subject matter.
2. In criminal law, the inclusion of a lesser offense within a more serious one, rather than charging it separately, this might cause double jeopardy.
3. In litigation, the doctrine that all of the plaintiff's prior claims are superceded by the judgment in the case, which becomes the plaintiff's sole means of recovering from the defendant.
4. The combination under modern codes of civil procedure of law and equity into a single court.
5. In corporate law, the acquisition of one company by another, and their combination into a single legal entity.

What Mergers actually mean:
A merger is a combination of two companies where one corporation is completely absorbed by another corporation. It may involve absorption or consolidation.

In absorption one company acquires another company. For example, Hindustan Lever Limited acquired Tata Oil Mills Company.

In consolidation, two or more companies combine to form a new company. For example, Hindustan Computers Limited, Hindustan Instruments Limited, Indian Software Company Limited, and Indian Reprographics Limited combined to form HCL Limited.

Merger is also defined as amalgamation. Merger is the fusion of two or more existing companies. All assets, liabilities and the stock of one company stand transferred to Transferee Company in consideration of payment in the form of:

- Equity shares in the transferee company,
- Debentures in the transferee company,
- Cash, or
- A mix of the above mode

Mergers vs. Acquisitions

These terms are commonly used interchangeably but in reality, they have slightly different meanings. An acquisition refers to the act of one company taking over another company and clearly becoming the new owner. From a legal point of view, the target company, the company that is bought, no longer exists. Acquisition in general sense is acquiring the ownership in the property. In the context of business combinations, an acquisition is the purchase by one company of a controlling interest in the share capital of another existing company.

A merger is a joining of two companies that are usually of about the same size and agree to meld into one large company. In the case of a merger, both company's stocks cease to be traded as the new company chooses a new name and a new stock is issued in place of the two separate company's stock. This view of a merger is unrealistic by real world standards as it is often the case that one company is actually bought by another while the terms of the deal that is struck between the two allows for the company that is bought to publicize that a merger has occurred while the company that is doing the buying backs up this claim. This is done in order to allow the company that is bought to save face and avoid the negative connotations that go along with selling out

Purpose of Mergers:

Purposes for mergers are short listed below:
(1)Procurement of supplies:
(2)Revamping production facilities:
(3) Market expansion and strategy:
(4) Financial strength:
(5) General gains:
(6) Own developmental plans:
(7) Strategic purpose:
(8) Corporate friendliness:

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(9) Desired level of integration:

Motivations for mergers

Mergers are permanent form of combinations which vest in management complete control and provide centralized administration which are not available in combinations of holding company and its partly owned subsidiary. Shareholders in the selling company gain from the merger and takeovers as the premium offered to induce acceptance of the merger or takeover offers much more price than the book value of shares. Shareholders in the buying company gain in the long run with the growth of the company not only due to synergy but also due to "boots trapping earnings".

Mergers are caused with the support of shareholders, manager's ad promoters of the combing companies. The factors, which motivate the shareholders and managers to lend support to these combinations and the resultant consequences they have to bear, are briefly noted below based on the research work by various scholars globally.

(1) From the standpoint of shareholders

Investment made by shareholders in the companies subject to merger should enhance in value. The sale of shares from one company's shareholders to another and holding investment in shares should give rise to greater values i.e. the opportunity gains in alternative investments. Shareholders may gain from merger in different ways viz. from the gains and achievements of the company i.e. through

(2) From the standpoint of managers

Managers are concerned with improving operations of the company, managing the affairs of the company effectively for all round gains and growth of the company which will provide them better deals in raising their status, perks and fringe benefits. Mergers where all these things are the guaranteed outcome get support from the managers. At the same time, where managers have fear of displacement at the hands of new management in amalgamated company and also resultant depreciation from the merger then support from them becomes difficult.

(3) Promoter's gains

Mergers do offer to company promoters the advantage of increasing the size of their company and the financial structure and strength. They can convert a closely held and private limited company into a public company without contributing much wealth and without losing control.

(4) Benefits to general public

Impact of mergers on general public could be viewed as aspect of benefits and costs to:

- Consumer of the product or services;
- Workers of the companies under combination;
- General public affected in general having not been user or consumer or the worker in the companies under merger plan.

Types of mergers:

Merger depends upon the purpose of the offeror company it wants to achieve. Based on the offerors' objectives profile, combinations could be vertical, horizontal, circular and conglomeratic as precisely described below with reference to the purpose in view of the offeror company.

(A) Vertical combination:

A company would like to takeover another company or seek its merger with that company to expand espousing backward integration to assimilate the resources of supply and forward integration towards market outlets. The acquiring company through merger of another unit attempts on reduction of inventories of raw material and finished goods, implements its production plans as per the objectives and economizes on working capital investments. In other words, in vertical combinations, the merging undertaking would be either a supplier or a buyer using its product as intermediary material for final production.

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(B) Horizontal combination:

It is a merger of two competing firms which are at the same stage of industrial process. The acquiring firm belongs to the same industry as the target company. The mail purpose of such mergers is to obtain economies of scale in production by eliminating duplication of facilities and the operations and broadening the product line, reduction in investment in working capital, elimination in competition concentration in product, reduction in advertising costs, increase in market segments and exercise better control on market.

(C) Circular combination:

Companies producing distinct products seek amalgamation to share common distribution and research facilities to obtain economies by elimination of cost on duplication and promoting market enlargement. The acquiring company obtains benefits in the form of economies of resource sharing and diversification.

(D) Conglomerate combination:

It is amalgamation of two companies engaged in unrelated industries like DCM and Modi Industries. The basic purpose of such amalgamations remains utilization of financial resources and enlarges debt capacity through re-organizing their financial structure so as to service the shareholders by increased leveraging and EPS, lowering average cost of capital and thereby raising present worth of the outstanding shares. Merger enhances the overall stability of the acquirer company and creates balance in the company's total portfolio of diverse products and production processes.

Concerns of mergers

Horizontal, vertical, and conglomerate mergers each raise distinctive competitive concerns.

Horizontal Mergers Horizontal mergers raise three basic competitive problems. The first is the elimination of competition between the merging firms, which, depending on their size, could be significant. The second is that the unification of the merging firms' operations might create substantial market power and might enable the merged entity to raise prices by reducing output unilaterally. The third problem is that, by increasing concentration in the relevant market, the transaction might strengthen the ability of the market's remaining participants to coordinate their pricing and output decisions. The fear is not that the entities will engage in secret collaboration but that the reduction in the number of industry members will enhance tacit coordination of behavior.

Vertical Mergers Vertical mergers take two basic forms: forward integration, by which a firm buys a customer, and backward integration, by which a firm acquires a supplier. Replacing market exchanges with internal transfers can offer at least two major benefits. First, the vertical merger internalizes all transactions between a manufacturer and its supplier or dealer, thus converting a potentially adversarial relationship into something more like a partnership. Second, internalization can give management more effective ways to monitor and improve performance.

Conglomerate Mergers Conglomerate transactions take many forms, ranging from short-term joint ventures to complete mergers. Whether a conglomerate merger is pure, geographical, or a product-line extension, it involves firms that operate in separate markets. Therefore, a conglomerate transaction ordinarily has no direct effect on competition. There is no reduction or other change in the number of firms in either the acquiring or acquired firm's market.

Corporate merger procedure

State statutes establish procedures to accomplish corporate mergers. Generally, the board of directors for each corporation must initially pass a resolution adopting a plan of merger that specifies the names of the corporations that are involved, the name of the proposed merged company, the manner of converting shares of both corporations, and any other legal provision to which the corporations agree. Each corporation notifies

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all of its shareholders that a meeting will be held to approve the merger. If the proper number of shareholders approves the plan, the directors sign the papers and file them with the state. The secretary of states issues a certificate of merger to authorize the new corporation.

Some statutes permit the directors to abandon the plan at any point up to the filing of the final papers. States with the most liberal corporation laws permit a surviving corporation to absorb another company by merger without submitting the plan to its shareholders for approval unless otherwise required in its certificate of incorporation.

Statutes often provide that corporations that are formed in two different states must follow the rules in their respective states for a merger to be effective. Some corporation statutes require the surviving corporation to purchase the shares of stockholders who voted against the merger.

Cases of mergers of prominent companies in the recent past

Case 1: Arcelor Mittal merger details

(Merger success)

The Merger Process

2006 was a very exciting and challenging year for Arcelor Mittal. The new company was at the forefront of the consolidation process, leading the industry through mergers and acquisitions.

January 2006 Historic moment for the Global Steel Industry

The year started with the historic launch of the Mittal Steel offer to the shareholders of Arcelor to create the world's first 100 million tonne plus steel producer. The aim of increasing globalization and consolidation, necessary in the steel industry, defines the deal and sets the pace for the industry.

February 2006 - Expansion and strong results

Mittal Canada completes the acquisition of three Stelco subsidiaries, the Norambar and Stelfil plants, located in Quebec, and the Stelwire plant in Ontario. Stelfil and Stelwire will add 250,000 tones of steel wire to the company's annual production capacity, providing a wider product mix to better meet customers' needs.

Arcelor acquires a 38.41% stake in Laiwu Steel Corporation, in China. Laiwu Steel Corporation is China's largest producer of sections and beams, and will further boost its operational excellence thanks to this partnership. It is still awaiting approval with the Beijing authorities.

April 2006 - Renewal after Hurricane Katrina and new galvanized line

Out of the devastation of Hurricane Katrina, arose a revitalized Mississippi youth baseball field, rebuilt with the help of Mittal Steel USA and Arcelor. The company provides money towards the purchase of lighting fixtures and steel cross bar support. It also arranges for and donates the labor costs for their installation.

Mittal Steel USA places a new line into operation in Cleveland to provide top-quality galvanized sheet steel to automakers and other demanding customers. The new line is designed to produce in excess of 630,000 tones of corrosion-resistant sheet annually, using the hot-dip galvanizing process.

May 2006 - US clears the way for bid

Mittal Steel announces US antitrust clearance for Arcelor bid and the approval of the offer documents by European regulators. The acceptance period starts in Luxembourg, Belgium and France on 18 May 2006 (some days later for Spain and the United States) and lasts until 29 June 2006.

Arcelor contributes to the first anti-seismic school building in Izmit (Turkey), where a school building had been destroyed by an earthquake in 1999.

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June 2006 - Historic agreement to create the No.1 Global Steel Company

Creating the world's largest steel company, Mittal Steel and Arcelor reach an agreement to combine the two companies in a merger of equals. The terms of the transaction were reviewed by the Boards of Arcelor and Mittal Steel which each recommended the transaction to their shareholders. The combined group, domiciled and headquartered in Luxembourg, is named Arcelor Mittal.

Demonstrating the commitment to extend markets in developing nations, a strategic partnership between Arcelor Mittal and SNI (Société Nationale d'Investissement) is concluded concerning the development of Sonasid. This consolidates and develops the position of Sonasid on the Moroccan market, allowing the company to benefit from the transfer of Arcelor Mittal's technologies and skills in the long carbon steel product sector.

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