DEMERGER , SYNERGY AND DEFENSIVE TECHNIQUES IN MERGER

DEMERGER

- A demerger is a form of corporate restructuring in which the entity's business operations are segregated into one or more components . It is the converse of a merger or acquisition

Demerger

Forms of Demerger:

- Spin-off
- Split-up
- Split-off

➡ *Spin-off*

- Spin-off involves transfer of all or substantially all the assets, liabilities, loans and business (on a going concern basis) of one of the business divisions or undertakings to another company whose shares are allotted to the shareholders of the transferor company on a proportionate basis.

- In spin-off, the transferor company continues to carry on at least one of the businesses.

➡ *Split-up*

- Split-up involves transfer of all or substantially all assets, liabilities, loans and businesses (on a going concern basis) of the company to two or more companies in which, again like spin-off, the shares in each of the new companies are allotted to the original shareholders of the company on a proportionate basis but unlike spin-off, the transferor company ceases to exist.

Spin-off and Split-up: Common Points

- In spin-off and split-up, there is no sale of assets to another company.
- In spin-off and split-up, shareholders of the transferor company receive consideration for transfer of assets by the transferor company.
- In both the cases, consideration is always in the form of equity shares of the transferee company(ies) .
- Companies wanting to carry out demerger in the form of spin-off or split-up have to ensure that consideration is paid only in the form of shares.

➡ *Split-off*

- Split-off is a spin-off with the difference that in split-off, all the shareholders of the transferor company do not get the shares of the transferee company in the same proportion in which they held the share in the transferor company.

- Most of the time, in split-off, some of the shareholders get shares in the transferee company in exchange of shares in the transferor company.

- Normally split-offs are used to realign the inter se holding of promoters while businesses are being split-off and brought under control of respective factions.

SYNERGY IN MERGER

- M & A is primarily a growth strategy. However, apart from the lure of quantum growth in shortest possible time, there are many other valid motives/ theories for which companies (acquirer companies) resort to M & A.

- ***Important points about Synergy Theory:***

1. Revenue generating synergies are far more difficult to achieve than cost reduction synergies.
2. Many a times, even honestly estimated synergies actually fail to materialize.
3. Many a times the acquirer’s management ends up knowingly overestimating synergies in order to justify the hefty control premium it pays or proposes to pay for the acquisition

- **The synergies are broadly divided into:**

(a) Revenue generating synergy-

Revenue generating synergy can be described as the generation of much higher growth rate and turnover than the individual companies' growth rates during independent operations.

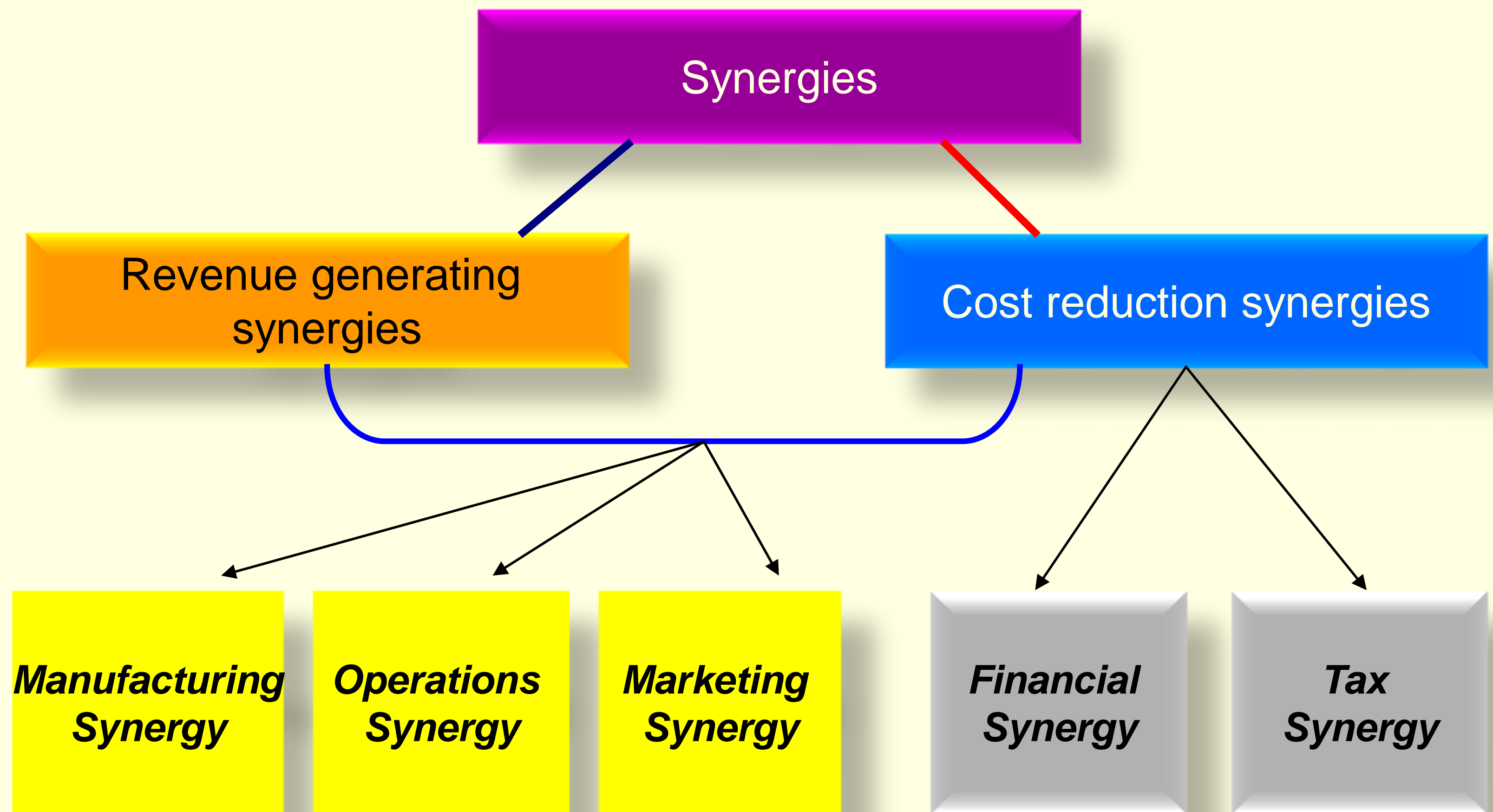
Example: Merger of ICICI with ICICI bank was to enhance the fee-based income.

(b) Cost reduction synergy-

If the combined operations result in cost savings, in any of the areas viz., manufacturing, marketing, operations, manpower, corporate overheads, etc., it would be the case of cost reduction synergy.

Types of Synergy

- **There are five types of synergies**



(a) Manufacturing Synergy

It involves combining the core competencies of the acquirer company in different areas of manufacturing, technology, design and development, procurement, etc.

Examples:

➡ ***Tata Motors acquisition of Daewoo's commercial vehicle unit;***

Synergy: It gave Tata Motors an advantage of producing commercial vehicles in the 200-400 bhp range.

➡ ***Daiichi Sankyo and Ranbaxy deal***

Synergy: R & D strength of Daiichi was combined with the efficient manufacturing of Ranbaxy.

(b) Operations Synergy

- **It involves rationalizing the combined operations in such a manner that through sharing of facilities such as warehouses, transportation facilities, software and common services, etc., duplication is avoided and logistics are improved leading to quantum cost saving.**

Examples:

- ***Kingfisher Airlines acquired Deccan Airways***

Synergy: To achieve substantial savings through rationalization of routes, reduction in the combined number of flights on the same routes, sharing of commercial and ground handling staff, reduction in the combined number of airplanes in use, etc.

- **Marketing Synergy**
- It involves using either the **common sales force or distribution channel** or media to push the products and brands of both the acquirer and target companies at lower costs than the sum total of costs that they would incur in independent marketing operations.

- Involves leveraging on the **brand equity** of one of the two companies to push the sale of the second company's products.

- Can involve acquiring better **pricing power** on account of two companies coming together.

(d) Financial Synergy

- It involves **combining** both the acquirer and target companies' **balance sheets** to achieve either a reduction in the weighted average cost of capital or a better gearing ratio or other improved financial parameters.

- In this, one has to effect the target company's merger with the acquirer company.

(D) TAX SYNERGY

•It involves merging a loss-making company with a profitable one so that the profitable company can **get tax benefits** by writing off accumulated losses of the loss-making company against the profits of the profit making company.

Defensive Tactics in Merger

- ***Divestiture***
- ***Crown jewels***
- ***Poison pill***
- ***Greenmail***
- ***White knight***
- ***Golden parachutes***

Regulation of Mergers and Takeovers in India

- **In India, mergers and acquisitions are regulated through:**
  - The provision of the Companies Act, 1956,
  - The Monopolies and Restrictive Trade Practice (MRTP) Act, 1969,
  - The Foreign Exchange Regulation Act (FERA), 1973,
  - The Income Tax Act, 1961, and
  - The Securities and Controls (Regulations) Act, 1956.
    - The Securities and Exchange Board of India (SEBI) has issued guidelines to regulate mergers, acquisitions and takeovers.

Regulation of Mergers and Takeovers in India

- **Legal Measures against Takeovers**
- **Refusal to Register the Transfer of Shares:**
  - a legal requirement relating to the transfer of shares have not be complied with; or
  - the transfer is in contravention of the law; or
  - the transfer is prohibited by a court order; or
  - the transfer is not in the interests of the company and the public.
- **Protection of Minority Shareholders' Interests**
- **SEBI Guidelines for Takeovers:**
  - ***Disclosure of share acquisition/holding***
  - ***Public announcement and open offer***
    - ***Offer price***
    - ***Disclosure***
    - ***Offer document***

Legal Procedures

- ***Permission for merger***
- ***Information to the stock exchange***
- ***Approval of board of directors***
- ***Application in the High Court***
- ***Shareholders' and creditors' meetings***
- ***Sanction by the High Court***
- ***Filing of the Court order***
- ***Transfer of assets and liabilities***
- ***Payment by cash or securities***

REFERENCES

- Financial Management, Ninth Edition © I M Pandey.,Vikas Publishing House Pvt. Ltd.