

**AN EXPLORATORY STUDY ON MERGERS AND ACQUISITIONS OF  
MULTINATIONAL COMPANIES WITH SPECIAL REFERENCE TO  
INDIA AND THE LEGALITIES INVOLVED**

Aaliya Chug

The Shriram Millennium School Noida

DOI: 10.46609/IJSSER.2023.v08i06.029 URL: <https://doi.org/10.46609/IJSSER.2023.v08i06.029>

Received: 20 June 2023 / Accepted: 28 June 2023 / Published: 30 June 2023

**ABSTRACT**

The paper researches the various reasons for mergers and acquisitions that take place in the globalised world today. The reasons are different for different companies. The main reason is profit-making, enlarging one's market share, reducing costs, and getting rid of competition at times leading to monopolistic tendencies where prices can be dictated. In the process, there might be a large number of advantages and disadvantages and not necessarily all M&As are profit-making ventures.

**Keywords:** Merger and Acquisition, Competition, Sales revenue, Profitability, Horizontal Integration, Vertical Integration,

**Research Question:** The research paper will attempt to look in detail at the reason and the impact of mergers and acquisitions of multinational companies. Indian companies too are now transnational in nature. All acquisitions need to follow the law of the land, and these would be different for different countries. How do mergers manage such situations? Do they reach increasing levels of profitability in the process? How long do these mergers take? Do they stifle competition? These and more are some of the questions that would be attempted to be answered in the course of the paper.

**1. Introduction**

Multinational companies (M&A) and laws of the land are all words that are commonly used in the world today. The present type of mergers that are taking place is due to globalisation of the world economy. With the spread of this and liberalisation, it has become easier for companies to work across the globe. India opened up its shores in the 1990s. Prior to that, it was stifled by the 'Licence Raj' and inward-looking strategies. Essentially meaning that whatever was required by

the economy should be produced within the economy, aiming at self-sufficiency and import substitution. This led to major problems in the fiscal deficit (a condition when the expenditure of the government exceeds its revenue in a year) of the economy, leading to the opening up of the economy in the 1990s. High fiscal deficits are detrimental to the growth of the economy and most economies try to minimise this component. India, in recent times, has attempted to restrict it to close to 3.5% of GDP.

India's industrial and services sectors have grown manifold since the 1990s. There were apprehensions that with the opening up of the economy in the 1990s, a large number of business houses would not be able to face foreign competition. However, not only were the Indian sectors in a position to stand up to the competition but the services sector came into its own after the 1990s.

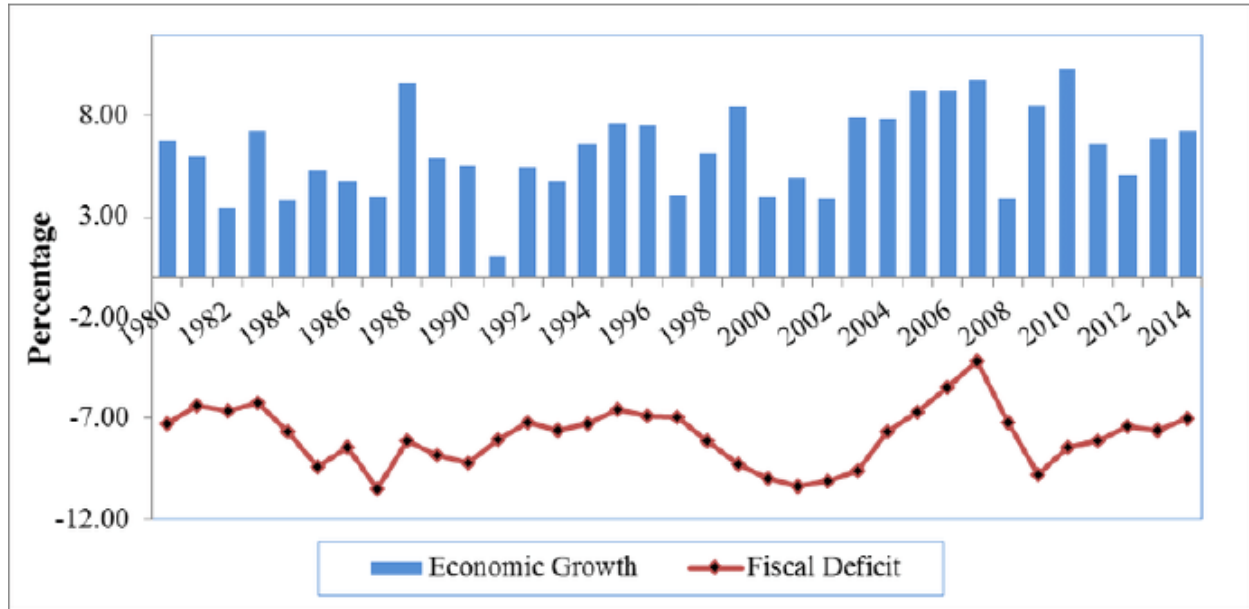
With no government intervention and a level playing field, a large number of the Information Technology (IT) sector started developing and competing with other companies of the world, so much so that the products that were produced started being exported all over the world.

The 1990s were a game changer for the service industry in India. As the fiscal deficit came into control, the opportunities for various sectors to grow due to both domestic and foreign demand started increasing by leaps and bounds. These industries started setting up offices globally. Eventually, the Indian industries became multinational in their own right.

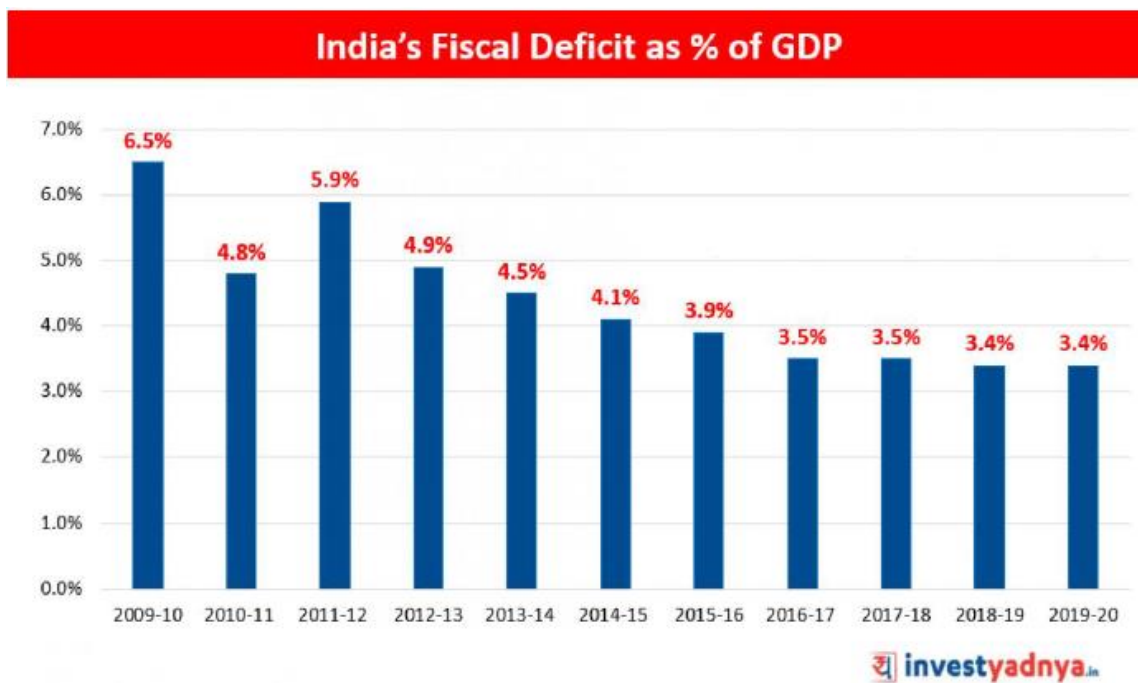
All this has been indicated by an increase in the industrial growth rate that started a rising trend from 1992-1993 onwards from 2.3% to 9.1% in 1994-1995 and 13% in 1995-1996. The aim of the new industrial policy of 1991 was to correct the existing market distortion which might prevent the growth of the industries, to provide gainful and productive employment, and to retain global competitiveness. Indian industries were given the freedom to import capital goods like machinery and raw materials. This was extremely important as India is primarily a labour-surplus economy, and there was a shortage of capital.

A large amount of the imports that took place were used to further export. Due to this phenomenal increase in growth, the GDP moved towards 6.7% in the 5 years from 1992-1997 compared to just over 1% in the three decades from 1951 to 1980.

Figure 1: Comparison of GDP in India from 1980 to 2020



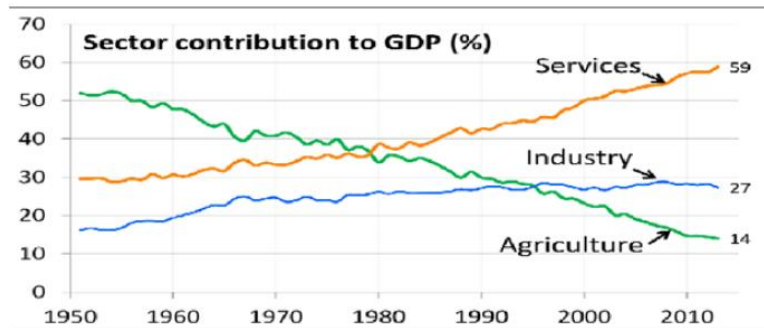
1(a)Source: Google Image



1(b) Source: investyadnya

The reforms introduced after 1991 led to privatisation of certain public sector industries. It opened up sectors that were earlier just reserved for the public sector, and it also led to a huge expansion in the production of the consumer goods sector.

**Figure 2: Sectoral Impact of 1991 Reforms**



Source: Google Image

The above diagram indicates the tremendous growth of the service sector after the reforms. This is the basis for companies in the service sector to become multinational eventually.

## 2. Definitions

There is an imperative need to understand the implications of multinational corporations whether their origins are Indian or any other country in the world. One impact of these industries is that as they grow, they have access to various markets. It is these markets that provide the demand for their product which in turn spurs production, leading to profits.

### 2.1. Multinational Corporations

**Figure 3: Multinational Corporations**



Source: Google Image

Multinational corporations, also known as multinational enterprises, are companies that do business in a select few countries worldwide and operate facilities such as warehouses or distribution in at least one foreign country. These companies are often managed from a central office that is likely to be situated in the home country. They are categorised into four different types:

- **Decentralised Multinational Corporations:** These corporations maintain a prominent presence in their country of origin. Every office in any other country posts a unique management structure. For example, Tesco.
- **Centralised Global Corporations:** They have a central headquarter in the home country where officers and managers oversee the global offices and operations along with all domestic operations. The key business decisions are made in the country of origin. Coca-Cola is an example of a centralised global corporation.
- **International Companies:** An international company is one which is based in the home country of the company and is involved in importing and exporting to international markets.
- **Transnational Enterprises:** Transnational enterprises are those which are involved in the international production of goods and services, foreign investment, income, and asset management in more than one country. They set up factories in emerging market economies as land and labour are cheaper in these countries.

**Figure 4: Types of multinational corporations**



Source: Google Image

## **2.2. Mergers**

A merger is an agreement that unites two existing companies into a new company. It is the consolidation of companies or their major business assets through financial transactions between companies. A company may purchase or absorb another one outright or it could merge with it to create a new company. It could acquire some or all of its major assets, or it could make a tender offer for its stock. It is a bid to purchase some or all of the shareholder's stock in a corporation. This offer is made publicly and invites shareholders to sell their shares for a specified price and for a specified time period. The price that is offered to the shareholders is normally at a premium compared to the market price and is dependent upon a minimum or maximum number of shares sold. It is a public announcement to shareholders to sell their shares. A tender could also take the form of a takeover in which case the main condition would be that the buyer is able to obtain a certain number of shares such that they are in a position of controlling interest. The shares of the stock purchased in a tender offer then become the property of the purchaser and now it depends on the shareholder whether they decide to hold or sell the shares. The advantages of a tender offer underlie the fact that investors are not obligated to buy the shares until a set number is tendered. This eliminates large upfront cash outlays and prevents investors from liquidating stock positions if offers fail. At times the government can reject a proposition citing antitrust violations. In India, the watchdog for this is the Competition Commission of India or the CCI. The disadvantages are that it may result in becoming an expensive way to complete a hostile takeover. There are five commonly known business mergers:

- Conglomerate merger: This is between companies in unrelated business activities, for example, a clothing company buys a software company.
- Horizontal merger: This is a merger between companies in indirect competition with each other regarding product lines and markets.
- Vertical merger: This is a merger between companies that are along the same supply chain, for example, a retail company in the auto parts industry merges with a company that supplies raw materials for auto parts.
- Market extension merger: An amalgamation between companies in different markets that sell similar goods and services.
- Product extension merger: In this case, it is between companies in the same market that sell different but related goods and services.



**Figure 5: Tender Offer**



Source: Google Image

### **2.3. Acquisition**

This is a business transaction in which one firm buys all or part of another company's stock or assets. Just like in mergers, there are four main types of acquisition depending on the relationship between the buyer and the seller. These are:

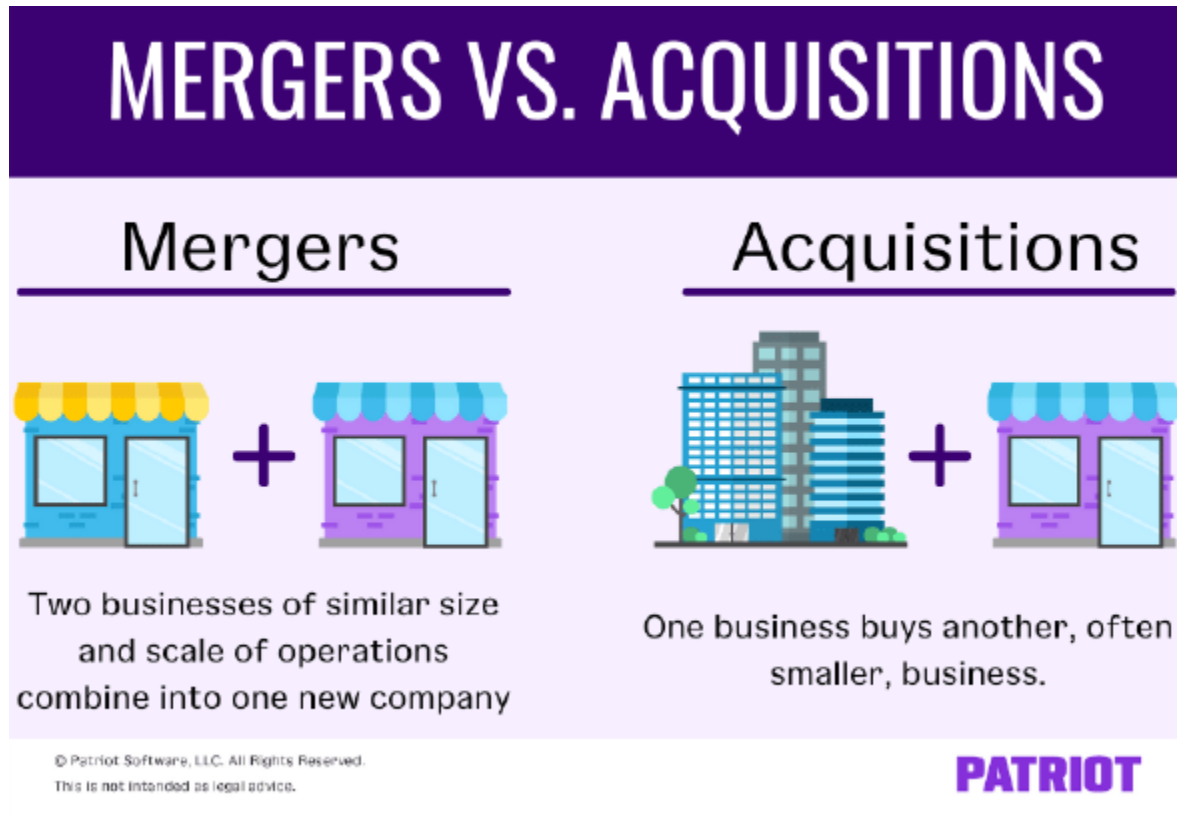
- Horizontal
- Vertical
- Conglomerate
- Congeneric

The five stages that a merger and acquisition normally follow are:

1. Assessment and preliminary review
2. Negotiation and letter of intent
3. Due diligence
4. Negotiations and closing

5. Post-closure integration/ implementation

Figure 6: The difference between mergers and acquisitions



Source: Patriot

## 2.4. Legal Aspect

The legal aspects of merger and acquisition involve the following:

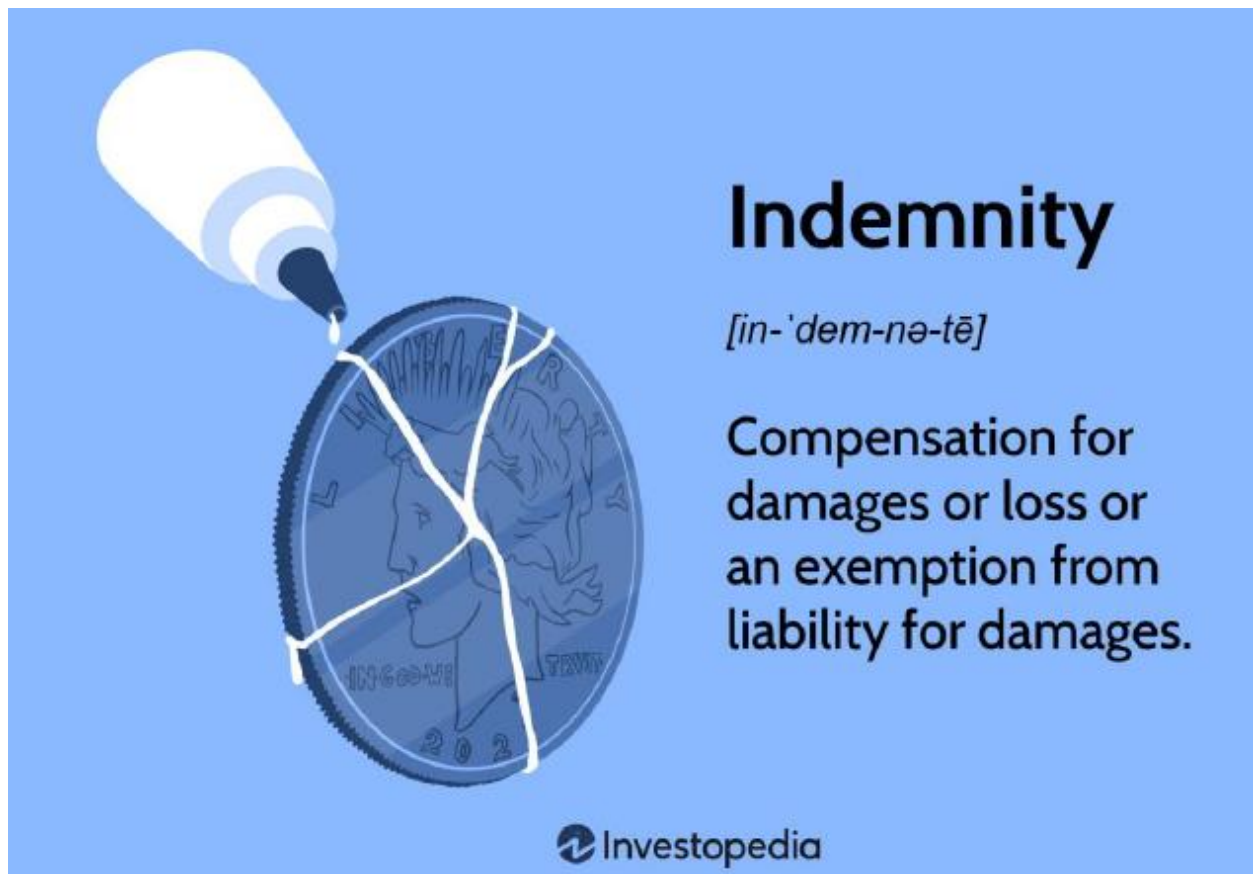
- Deal structure: This is as much as legal as it is financial as whatever deal is struck it needs to be legally adhered to. The deal structure consists of a timeline, stock purchasing, asset purchasing, and merger.
- Equity and Cash: Cash is the easiest, safest, and most flexible method for acquiring a company. Equity, on the other hand, requires a ratio that has to be given to the stockholders at a ratio relative to the company's value. Issuing equity may reduce the cost of debt financing as it improves the debt rating of the acquiring company.
- Working capital adjustments: Acquiring companies need to ensure that their target



company has adequate working capital in order to deal with all obligations before and after the closure.

- Indemnification: This is important in mergers and acquisitions as they are essential clauses that seek to protect what has been discussed.

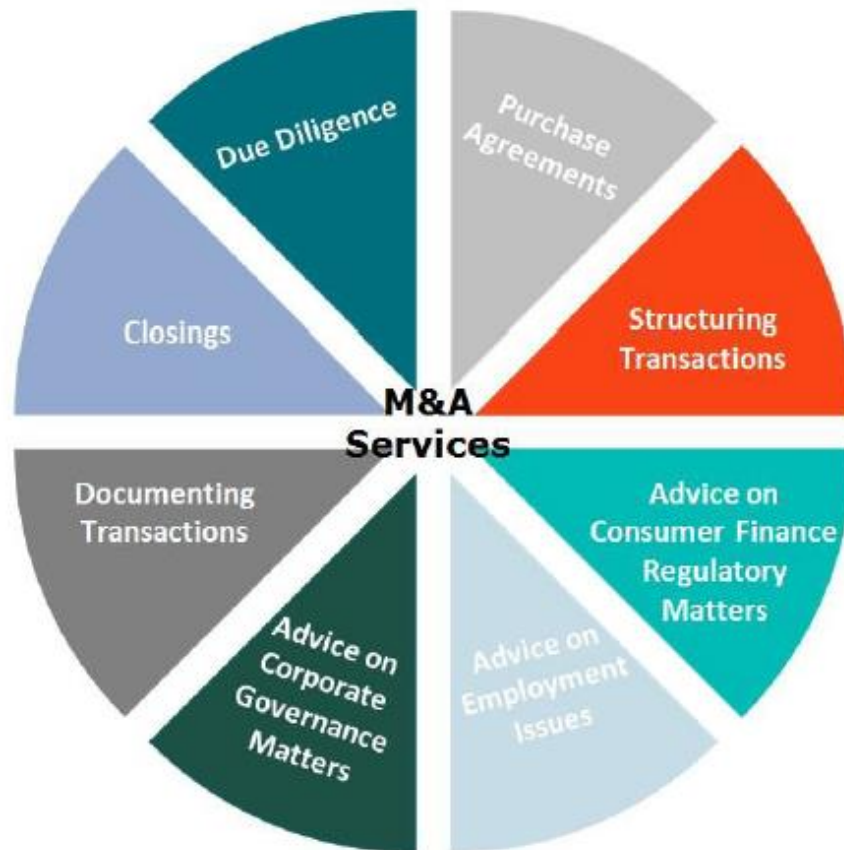
**Figure 7: What is indemnity**



Source: Investopedia

- Representation and Warranties: These entail numerous rounds of talks between buyers and sellers with respect to the acquirer and the seller.
- Due diligence: This is the most important function of corporate merger and acquisition attorneys' to-do list. It covers every aspect of the company.
- Closing conditions: This is the final agreement that has to be vetted by both sides to achieve a smooth acquisition.

**Figure 8: Legal Aspects of Mergers and Acquisitions**



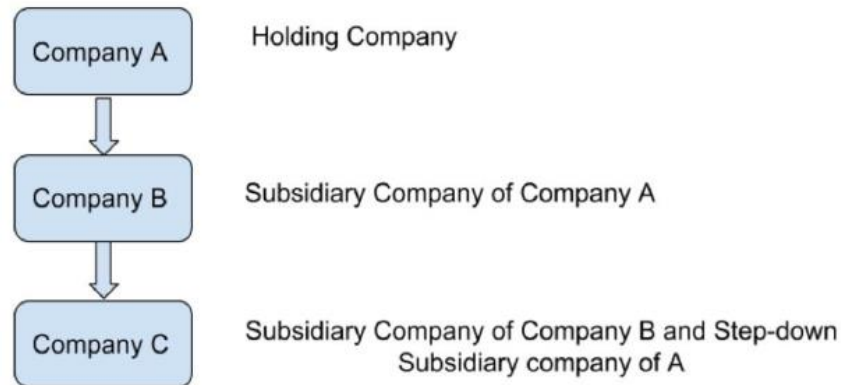
Source: Google Image

### **3. Impact of Merger and Acquisition (M&A) on the parent company**

There are different impacts on the parent company depending upon the type of company that is acquired. If the parent company receives a competitor, then it gains access to new resources and human capital, resulting in an enhancement of both the above factors. Brand visibility increases manifold. It is also possible that stock prices increase as a result of the combined assets and reduced costs. Incremental growth may definitely occur as a result of the above. If the merger is with a subsidiary, then the buyer, which is the parent company, becomes the only shareholder.

Mergers and Acquisitions can be exciting but also tense for a company. Capabilities may be increased, and products can be diversified, however, the transaction can cause stress and uncertainty for employees and could lead to a decrease in productivity for businesses.

**Figure 9: How do subsidiary mergers work?**



Source: Google Image

### 3.1. On profitability

To understand the impact on profitability, in general, there are six ratios which are used:

- Profit after tax: Profit after tax shows the earnings of a business after all tax deductions have been made.
- Return on asset: Return on assets indicates the relationship between the profitability and assets of a firm.
- Return on equity: Return on equity is usually a way to measure the financial performance of a business in terms of its efficiency to generate profits.
- Debt to equity: Debt to equity shows the correlation between the indebtedness of a company and its assets.
- Deposit to equity: Deposits are liabilities of the company. Deposit to equity is the capital contribution that is provided by the company and borrowed by them.

Mergers take place to gain:

- Market share
- Competitive advantage
- Increase in revenue.
- Product diversification

In the short run, the immediate impact of profitability does not exist. In fact, there might be a deterioration in the profitability as a large number of funds have been shelled out in acquiring the new firm, and it is possible that the return on capital and earnings per share might have declined significantly following the merger. Research has indicated that cross-border mergers may not show a very high profitability, while domestic mergers may in fact indicate a statistically significant profit. For example, the Centurion Bank of Punjab Ltd. by State Bank of India Ltd. resulted in a significant increase in profit. There were eight subsidiaries of the State Bank of India which merged with the parent bank, these were the State Bank of Mysore, Saurashtra, Patiala, Jaipur, Hyderabad, Bikaner, Mahila Bank, and Travancore. This was profitable for the State Bank of India as there was duplication of offices, systems, people, and the profits were being divided. On their own, they were not profit-making entities.

When it is seen that the entities are not profit-making, then it is prudent to merge the company with the parent company. But when the subsidiaries are profit-making on their own, the cost of acquiring them increases, and thus it takes longer for systems to work whereby they earn profit.

The extent of profitability after a merger depends on the type of companies, subsidiaries, and ancillaries that are being amalgamated and whether they are profit-making or not as this has a direct impact on the cost of acquiring the company.

**Figure 10: Subsidiaries merged with State Bank of India**



Source: #SBIBacktrack

### **3.2. On-sales revenue**

The impact of mergers on sales revenue will entirely depend on whether the acquired company is catering to the same market. This means that one has merged with a competitor. The second type of merger is when one wants to add a subsidiary company to one's rapporteur whether it is a horizontal or vertical integration of the process of manufacturing in which case sales revenue is impacted because prices can be manipulated to increase revenues. If the merger has increased market share, then definitely sales will increase, however, in the case of the State Bank merger, the result was that it avoided replication and may not have increased sales as the subsidiaries were loss-making entities.

### **3.3. On competition**

Mergers definitely aim to suppress competition so that they become either monopolists or oligopolists in their respective fields. Whether this is profitable or not will entirely depend on the cost of acquiring the company. Sometimes companies are merged not for suppressing competition but to enhance the products that they sell, or they have control over the raw materials that are required for production.

**Figure 11: Impact of Mergers and Acquisitions on Competition**



Source: Google Images

## **4. Advantages and Disadvantages of Mergers and Acquisitions**

The whole idea with respect to merger and acquisition is the fact that when this amalgamation takes place, it is likely to be in similar products or products that enhance profitability in the same sphere. It is extremely unlikely that a company acquires a product that is completely dissimilar from the one that it is producing.

The advantages of M&A are:

- They could effectively stifle competition. In such cases, the larger firm tends to takeover small firms which are considered competitors.
- To avoid replication. This was clearly seen in the merger of various state bank subsidiaries with the main state bank of India. In this case, the subsidiaries were not profit-making entities, and any shortfall in revenue was being provided by the parent State Bank of India. How long could profits be diverted into loss-making units just so that political compulsions are being addressed? This was the main reason why all the subsidiary banks merged with the State Bank of India.
- Both horizontal and vertical integration help the parent company especially when they want to expand in a similar sphere, for example, IBM bought the software firm Apptio as they needed to increase their capability in 'cloud' and 'automation'.

such that they would be on a level playing field with other big players in this sphere.

The disadvantages of M&A are:

- Profits may not be immediately realised as a large number of funds would have been diverted into acquisitions. If the unit being acquired is in itself an extremely high profit-making entity, then the cost of the merger increases and profit-making is pushed back.
- It becomes difficult to manage manpower and property once M&A takes place. The people who are being laid off as their jobs are being duplicated undergo a large amount of stress which could hamper a smooth M&A. To keep everyone fairly satisfied, 'golden handshakes' might have to be resorted to. This, again, adds to the cost of the merger.
- At times, M&A can be conducted for the wrong reason eg asymmetric information which results in moral hazard and an adverse selection.
- Due diligence is a complex and time-consuming task.
- Valuations are an inexact science.

## **5. Conclusion**

Mergers and Acquisition are two very complex concepts. There are a number of factors that are involved when any such decision is taken. It may not necessarily be profitable immediately for the parent company. There are different types of M&A that take place for different reasons. The



factors that are commonly considered are profitability, sales revenue, and competition. Some of the M&A takes place for vertical integration and others for horizontal integration of the product. If the company that has to be merged is in itself a profitable entity, then the cost of acquiring it can be a long drawn out and expensive proposition. There could be at times hostile takeover of companies which automatically increases the expenditure involved. The size of the company which is to be acquired also matters. M&A activity has increased since the world has universally globalised, aided by the spread of internet data exponentially. There is no one clear path that a company can follow while merging or acquiring another. Each decision is unique and thus different methods are adopted.

### **Bibliography**

1. Blakely-Gray, R. (2022, October 24). *Mergers vs. Acquisitions / Differences, Similarities, & More*. Patriot Software. <https://www.patriotsoftware.com/blog/accounting/mergers-vs-acquisitions/>
2. Dutta, D. (2022, July 12). Mergers And Acquisitions In India – A Brief Overview. *Monday*. <https://www.mondaq.com/india/corporate-and-company-law/1210798/mergers-and-acquisitions-in-india--a-brief-overview>
3. Haroon Ahmadi, M. (2021). India's Fiscal Deficit and its Impact on Gross Domestic Product: An Analysis; Mohammad Haroon Ahmadi. *Research Gate*.
4. Hayes, A. (2023). Indemnity: What It Means in Insurance and the Law. *Investopedia*. <https://www.investopedia.com/terms/i/indemnity.asp#:~:text=Indemnity%20is%20a%20type%20of,damage%20caused%20by%20another%20party.>
5. Kedia, S., & Kedia, S. (2020, January 8). The Difference Between International, Multinational, Transnational & Global Companies. *Marketing Mind*. <https://www.marketingmind.in/the-difference-between-international-multinational-transnational-global-companies/>
6. Picardo, E. (2022). How M&A Can Affect a Company. *Investopedia*. <https://www.investopedia.com/articles/investing/102914/how-mergers-and-acquisitions-can-affect-company.asp>
7. *Signs of optimism in the M&A market*. (2023, May 16). McKinsey & Company. <https://www.mckinsey.com/capabilities/m-and-a/our-insights/signs-of-optimism-in-the-m-and-a-market>