# 5.ISSUES AND CHALLENGES IN THE TRANSFER OF SHARES WITH CASE OF MERGERS AND ACQUISITIONS IN CORPORATE SECTORS : A STUDY

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## Abstract

This research article in simple terminologies tends to discuss the variety of issues that crop up before and after any share transfer takes places in a transaction of M&A. The author has explained the meaning of the same in brief and then dealt with the mechanism by which shares are transferred with an M&A transaction. Then the author has enumerated upon the issues which arise because of such transfer. Surprisingly enough, these issues are not only related to finance or taxation, they are often linked to IPR also as share transfer in broad terms is transfer of ownership only.

Keywords : Mergers, acquisitions, company, procedure, share.

## 1.Introduction

Despite mergers and acquisitions being a common practice in the current era of industrial and commercial globalization, it has not been defined under any statute, be it Companies Act, 2013 and Income Tax Act, 1961. The term "merger" refers to the merging of two or more companies into one, with the goal of not only accumulating the assets and liabilities of the separate entities, but also organizing them into one company. Mergers may be used to achieve a variety of goals, including cost savings, technology acquisition, and access to new markets and industries. A merger or acquisition is a merger or purchase of two businesses in which one company is fully absorbed by the other. The less significant firm loses its identity and merges into the larger business, which keeps its identity. The combined corporation is dissolved, and the remaining company inherits all of the merged corporation's rights, privileges, and obligations. A merger is not the same as a consolidation, in which two companies combine and lose their individual identities to create a single company. In most cases, the combining corporations will no more exist and will exist as one firm. However, ITA defines a similar word "amalgamation" as "the merging of one or more businesses with another company, or the combination of two or more firms to create a single company." It lists a number of additional requirements that must be met for an 'amalgamation' to be eligible for tax advantages.[1] Mergers and Acquisitions give rise to several issues having much impact when it comes to finances and distribution of liability. Shareholders experience several

[1] Garima Mittal, "Merger and Amalgamation in India", Tax Guru (July 7, 2021, 03:00 pm) https://taxguru.in/company-law/merger-amalgamation-india.html

impacts of such transactions - most of them good and some of them bad. Hence, it is essential to analyze how share transfer faces several impediments under an M&A transaction.

## 2.Procedure of M&A

The following are the steps in a typical M&A deal:[2]

1. Formulate a plan - A strong strategy starts with acquirer having a proper understanding of their aim in such transaction ie what their goal is in purchasing the firm.
2. Establish search criteria - Finding most important criteria for identifying prospective target businesses.
3. Searching and assessing targets - The acquirer searches and assesses targets by making use of parameters established.
4. Begin acquisition planning - The acquirer contacts businesses which match its search criteria and seem to provide excellent value.
5. Perform a valuation analysis – Assuming that initial contact and conversations go well, acquirer will ask target company to provide significant information that will allow acquirer to further evaluate target.
6. Negotiations - The acquirer should have enough information to build a fair offer after developing multiple value models for target business. Following presentation of first offer, two businesses may further discuss conditions.
7. Due diligence – Due diligence is a thorough examination and analysis of every aspect of target company's operations, including financial metrics, etc. By performing a thorough investigation and analysis of every element of the target company's activities, it attempts to validate or rectify acquirer's estimate of target company's worth.
8. Purchase and sale contract - Assuming that due diligence has been completed , next stage is to execute a final contract.
9. The acquisition's financing plan — Of course, acquirer will have looked into financing alternatives for transaction before signing agreement, but financing specifics usually come together after agreement is completed.
10. Ending and combining of purchase — The process is completed, and relevant teams come together on merger process.

## 3.Procedure of Transfer of Shares in M&A Transactions

One of the most important requirements for the Company form of business is the free transferability of shares, which is subject to certain limitations in private businesses.The term "transfer of shares" refers to voluntary

[2] Bill Snow, "Steps of the M&A Process", Dummies (July 7, 2021, 05:55 pm) https://www.dummies.com/business/corporate-finance/mergers-and-acquisitions/steps-of-the-ma-process/

transfer of ownership of shares from one party to other. The transmission of shares, on other hand, refers to transfer of ownership of shares via the legal process initiated by a legal heir. Transfer of shares requires payment of a stamp duty depending on the market value of the shares, while the transmission of shares method does not need payment of a stamp duty. The new legislation covers a lot of ground. The following sources should be consulted for statutory provisions relating to share transfer. [3]

1. Section 56 to 59 of Companies Act, 2013.
2. Rule 11 of Companies (Share Capital & Debentures) Rules 2014.
3. Provisions given in model AoA given in Table 'F' of Schedule-I.

Sec 56[4] states that a business would only register the transfer of its shares and other securities if a suitable instrument for transfer of shares (share transfer form) is submitted as specified in Form No. SH 4. One must stamp the SH 4 format for share transfer with the appropriate amount and date. It may also be completed by or on behalf of both the transferor and the transferee.Within 60 days after signing of the share transfer agreement, transferor or transferee of shares must submit Form SH 4 to the firm along with the share transfer certificate or the securities certificate. If there isn't a share transfer certificate, the application for transfer of shares must be accompanied by a letter of allocation of securities. In addition, within two weeks after receiving a notification, the buyer must provide a "No Objection Letter." Within one month after receiving the share transfer agreement or the share transfer certificate by the business, one must provide all of the company's share transfer certificates unless the business is unable to perform owing to a court order or other government directive. Companies Act 2013 stipulates that the share transfer document must be properly stamped. It further specifies that the stamp shall be of sufficient value for the date. When the share transfer form is to be submitted to board of directors, it should also be canceled in line with Section 12 of Indian Stamp Act. The stamp duty is paid by seller of shares at Rs 0.25 per Rs 100. Special adhesive stamps with phrase "share transfer" must be utilized for stamping purposes in a transfer of shares. India's electronic share transfer form is governed by Section 8A of the Indian Stamp Act. Stamp duty may be paid on the entire amount of shares or securities issued.

## 4.Issues and Challenges relating to Share's M&A

The aspect of share transfer from one company to another is not a smooth road. It involves several issues and challenges, not only before the deal but even in initial stages after the deal. Hence we shall deal with the issues and challenges under these two headers - Pre-closing issues and Post closing issues.[5]

### 4.1)Pre-Closing Challenges

**4.1.1)Identification of the Right Target -** Acquisitions provide potential to grow a company's size, market, and profitability in a relatively short period of time and money, but it all comes to nothing when businesses buy

[3] CS Tripti Shakya, "Provisions of Transfer of Shares under Companies Act 2013", Tax Guru (July 7, 2021, 04:54 pm) https://taxguru.in/company-law/provisions-transfer-shares-companies-act-2013.html

[4] The Companies Act, 2013.

[5] Aanchal Srivastava, "Challenges associated with share acquisitions",IPleaders (July 7, 2021, 01:00 pm) https://blog.ipleaders.in/challenges-associated-share-acquisitions/

wrongful target, at wrongful moment, and for wrongful price. Because acquirers are programmed to think that success is defined by completing a transaction, they often overlook the significance of selecting the appropriate target based on their intended advantages and goals. Furthermore, businesses are encouraged to continue with the transaction after reaching a particular stage, oblivious to the significance of terminating the transaction when it becomes apparent. As a result, choosing the incorrect business to acquire has become most common causes for M&As to fail.

**4.1.2)Insufficient Due Diligence –** It is most important and long-standing component of a successful business deal, and skimping on this step may have disastrous repercussions. Due diligence is investigating target company's legal and financial health in order to assess its development prospects. Poor due diligence may have a major effect on company's operations and image, leaving a lasting mark on the business. One such example is HP's purchase of Autonomy, which resulted in overpriced business and ultimately lead to substantial losses for HP due to severe problems such as inaccurate financial statements and cash flows. The Hon'ble SC ruled in McLeod Russel India Ltd vs. Regional Provident Fund Commissioner, Jalpaiguri that even if there is an agreement to contrary, the transferee entity is liable for any default committed by transferor entity, emphasizing the importance of thorough due diligence. Because the dangers of poor due diligence far exceed the related costs, the acquirer must devote a considerable amount of time and money to completing comprehensive due diligence.

**4.1.3)Regulatory and Tax Issues –** During a merger or acquisition process, there are a slew of industry-specific rules that must be followed, and non-compliance may jeopardize the deal's viability. Regulatory requirements may differ based on a variety of variables, including whether businesses involved are private or govt based, listed or unlisted, nature of transaction, and companies' size and share. SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011; Competition Act, 2002; Companies Act, 2013; Income Tax Act, 1961; and Foreign Exchange and Management Act, 1999 come into play when one of the parties is a foreign person or company.

**4.1.4)Employment Obstacles –** Mergers and acquisitions include many factors, and parties involved often make mistakes when it comes to the human aspect of the deal. When the founders want to remain but the acquirer wants them to go, or when founders want to leave but acquirer wants them to stay, problems may arise. In this respect, the PepsiCo purchase of Kentucky Fried Chicken (KFC) may be used as a model, since a significant portion of KFC's senior management as well as workers left shortly after acquisition due to communication and cultural problems. Furthermore, staff productivity is lost, and it may take up to three years to restore pre-acquisition engagement levels. As a result, it is essential that HR be kept informed and updated on choices that may impact them on a regular basis.

**4.1.5)Problems with Intellectual Property –** The Volkswagen - Rolls Royce deal of 1998 is a famous illustration of how a potential acquirer may suffer enormous losses if the target company's intellectual property

is ignored throughout the acquisition. Volkswagen paid $790 million for the returns it got from the transaction, oblivious to the fact that it had only bought right to manufacture and sell Rolls Royce cars, not ownership of the name and brand Rolls Royce. In today's "Idea Economy," acquirers must verify that the target firm has ownership of and rights to transfer intellectual property that is essential to its current and future operations, especially in e-commerce sectors. They may also demand compensation for damages suffered in relation to IPR or licenses as a result of a failure to acquire material consents and permissions from necessary parties.

**4.2)Post Closing Challenges**

**4.2.1)Business Integration –** A merger or acquisition transaction takes a lot of time and effort to complete, but there is a strategic difference between completing an acquisition and making an acquisition succeed. During merger of Daimler AG of Germany and Chrysler Corporation of United States, there was a huge conflict of cultures, values, and attitudes among workers of both companies, which resulted in senior Chrysler leaders resigning or being replaced by their German counterparts. As a result, the expected synergies vanished as the business suffered significant difficulties, and the acquisition was considered a flop. Integration issues may have far-reaching effects on the resulting entity's long-term performance and value, and might stymie the completion of a merger or acquisition deal.

**4.2.2)Issues of Non-Compete and Non-Solicitation –** Maintaining profitable talent and customer connections are critical to an institution's long-term standing. A covenant to not compete or solicit, in the context of M&A, means prohibition on selling shareholders from

(i) indulging in such commercial acts which are at par with target company, and

(ii) recruiting employees for a fixed time period and within reasonable geological limitations, after ending of work at target company. Consideration should be used to back up such limitations. The acquirer must take non-compete fees seriously in order to prevent the selling shareholders from evading these covenants and jeopardizing the transaction's intended outcomes.

**4.2.3)Escrow and Earn Out Issues —** In an M&A deal, escrow clauses protect the acquirer from any post-closing financial damages resulting from the target company's violation of any claims and warranties. Earn outs means extra price paid to selling shareholders in exchange for company's performance in future based on previously made financial metrics. Such provisions are difficult to bargain and are often cause of post-closing problems, since target company's profit generation may be impacted by a variety of unrelated variables such as the market climate and differences in corporate culture. As a result, these clauses should be carefully written, and the escrow and earn-out payment conditions should be explicitly stated in the M&A agreements.

## 5.Conclusion

M&A deals will remain common in India, given India's significance as a viable investment destination across world owing to its strong economic development rate. However a slew of hazards continue to contribute to high failure rates of these transactions. Cultural conflicts, poor integration, and overestimation of synergies may

sabotage the transaction's essence, resulting in a decrease in shareholder value and irreversible damage to the parties involved. As a result, it is critical that both buyer and seller thoroughly assess transaction's feasibility and work to strategically undertake purchase.