

17.3 CAPITAL STRUCTURE

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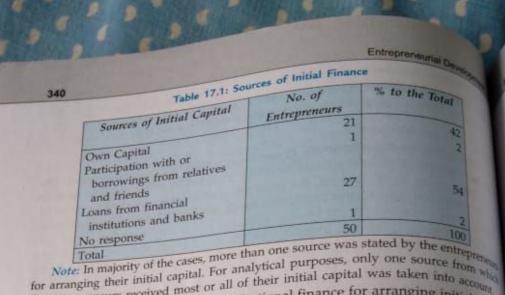
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nd banks as also the for one's heaviere

What is capital structure? You have just learnt that an enterprise/business raises funds from the internal and external sources. These take the forms of ownership capital and borrowed capital respectively. The former is also known as equity and the latter as debt. The composition of equity and debt in overall capital of an enterprise is called 'capital structure.' In simple words, capital structure is the ratio between debt and equity capital. Hence, it is also expressed as the debt-equity ratio.

Here, it must be noted that the term capital structure differs from financial structure. Capital structure means the permanent financing of the enterprise represented primarily by long-term sources of funds, i.e., debt and equity. Thus, rescludes funds raised from short-term sources. But, financial structure refers how the firm's assets are financed by raising funds from both long-term and short-term sources.

A business enterprise needs to maintain a proper ratio between these two in Order to function smoothly and efficiently. Then, the obvious question arises is nital structure? In fact, it depends



for arranging their initial capital. For analytical part for arranging their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs received most or all of their initial capital was taken into account the entrepreneurs and the entrepreneurs are account to the entrepreneur the entrepr entrepreneurs received most or all of the temperature of the heavy dependency upon institutional finance for arranging initial capital capital

is depicted in Figure. 17.2 also.

depicted in Figure. 17.2 also.

It is seen from Table 17.1 that the majority of the entrepreneurs (54) It is seen from Table 17.1 that the arranged their initial capital from institutional sources, followed by those who arranged their initial capital from internal sources. Of course, those who arranged their initial capital from their own internal sources. Of course, those who reliable their capital requirements arranged the same from their own internal their capital requirements were relatives and friends for arranging their capital requirements were relatives and friends as a last resort. on their relatives and friends for arranging and friends as a last resort. One the reason is that one relies on relatives and friends as a last resort. One is The reason is that one relies of reasons of personal esteem. At a usually unwilling to divulge what her same specially the relatives and friends for reasons of personal esteem. At the same especially the relatives and friends for relatives and banks as also their lower rates time, the popularity of financial institutions and banks as also their lower rates of interest on loans may be important reasons for one's heavier reliance on these institutions for seeking financial assistance.

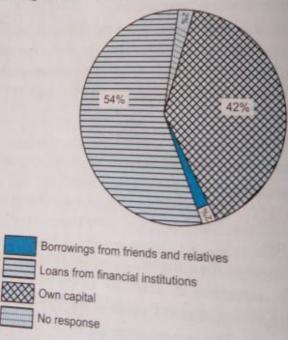


Figure 17.2: Heavy Dependency upon Institutional Finance

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173 CAPITAL S What is capital pises funds from ownership capital s equity and the apital of an ent smicture is the ra as the debt-equity Here, it must structure. Capita represented prin it excludes fund to how the firm short-term sour

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The capital structure should ensure the enterprise. In any case, it should not be a control chiuding one, the enterprise. In any case, it should not be a control chiuding one, the enterprise. (iv) The capital structure should ensu. (iv) The capital structure the enterprise. In any case, it should not be the enterprise. In any case, it should not be the enterprise. In any case, it should not be the said features appear to be common and major ones.

While one can add certain other features appear to be common and major ones. While one can add certain other leatures to these for some enterprises, the said features appear to be common and major ones.

Factors Determining Capital Structure ctors Determining Capital Structure in any enterprise depends on a variety of the business itself is one of a

Maintaining the crown of the business itself is one of the factor.

These include:

The nature of the businesses subject to be maintained. The businesses subject to be maintained and the proportion of borrows.

1. Nature of Business: The nature of the businesses subject to wild determining capital structure to be maintained. The businesses subject to wild determining capital structure to maintain smaller proportion of borrowed funds to leavisions. 1. Nature of Bush determining capital structure to be maintain smaller proportion of borrowed funds fluctuations in sales need to maintain smaller proportion, refrigerators, machine fluctuations in sales manufacturing televisions, refrigerators, machine in the sales manufacturing televisions in the sales manufacturing televisions in the sales machine in the sales manufacturing televisions in the sales man determining capital determining capital to maintain smaller per fluctuations in sales need to maintain smaller per fluctuations, refrigerators, machine to fluctuations in their sales. On the capital fluctuations in sales manufacturing televisions, machine to debt capital. Companies manufacturing televisions in their sales, on the debt capital. Companies manufacturing televisions in their sales, on the debt capital. Companies manufacturing televisions in their sales, on the debt capital companies manufacturing televisions in their sales. On the debt capital companies manufacturing televisions in their sales. On the debt capital companies manufacturing televisions in their sales. On the debt capital companies manufacturing televisions in their sales. On the debt capital companies manufacturing televisions in their sales. On the debt capital companies of businesses subject to fluctuations in their sales. On the debt capital companies of businesses subject to fluctuations in their sales. On the debt capital companies of businesses subject to fluctuations in their sales. On the debt capital companies of businesses subject to fluctuations in their sales. On the debt capital companies of businesses subject to fluctuations in their sales. debt capital. Comples of businesses subject to having inelastic demand like are examples of businesses subject to having inelastic demand like are examples of businesses subject to have larged solds having inelastic demand like contrary, the business firms dealing in items/goods having inelastic demand like contrary, the business firms dealing in have larger proportion of borrowed capital and the contrary of the businesses subject to have larged solds having inelastic demand like are examples of businesses subject to have a subj contrary, the business firms dealing in items / go contrary, the business firms dealing in items / go essential consumer goods may have larger proportion of borrowed capital. The reason is that these firms generally have stable earnings.

son is that these firms generally have also determined by the competitiveness. The capital structure of companies is also determined by the competitiveness in case of ready-made garments indicates the competitiveness. The capital structure of companies is also of ready-made garments industry found among them. For example, in case of ready-made garments industry found among them. For example, in case ships and fashions which are subject to frequent competition is mainly based on styles and fashions which are subject to frequent competition is mainly based on styles and the styles and unpredictable changes. As such, these firms have to depend less on borrowed and unpredictable changes. capital and more on equity or owner's capital.

- 2. Size of the Enterprise: Small enterprises have to rely less on borrowed 2. Size of the Enterprise: Small cheef and is because investors consider capital and depend more on owner's capital. This is because investors consider lending to small firms more risky. On the other hand, large enterprises are considered less risky. Therefore, investors believe that their money is safe and, hence, prefer to lend money to large enterprises. This enables the large enterprises to raise funds from different sources.
- 3. Trading on Equity: In case the rate of return on capital employed is more than the rate of interest on debentures or rate of dividend on preference shares, it is called trading on equity or leverage effect. In such case, there is greater dependence on borrowed capital in the capital structure.

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advantage of having an optimum financial structure, if such an optimum does exist, is two-fold. It minimises the company's cost of capital which in turn its ability to increase and find new wealth by creating investment opportunities. Also, by increasing the firm's opportunity to engage in future wealth-creating investment, it increases the economy's

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An optimum capital structure bears the following features: rate of investment and growth."

(i) The capital structure should involve the minimum cost and the maximum

(ii) The adopted capital structure should be flexible enough to fulfil the future requirements of the capital as and when needed.

(iii) The use of the debts should be within the repaying capacity of the enterprise. In fact, failure to recognize this important aspect is the common cause of financial strain among the small-scale enterprises.

(iv) The capital structure should ensure the proper control over the affairs of the enterprise. In any case, it should not be a control diluting one.

While one can add certain other features to these for some particular terprises, the said foot enterprises, the said features appear to be common and major ones.

Factors Determining Capital Structure

However, this finding goes against the findings of Nafzigir who found mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs usually did not have access to find the mall-scale entrepreneurs u Hovever, this place against the findings of Nafzigir who found the small-scale entrepreneurs usually did not have access to funds from the small-scale institutions. As a result, 44% entrepreneurs received their relatives and friends (Nafzigir entrepreneurs received to their relatives and friends (Nafzigir entrepreneurs received to their relatives and friends (Nafzigir entrepreneurs received to the small entrepreneurs recei the small-scale institutions. As a result, 44% entrepreneurs received most or spanished financial institutions and friends (Nafzigir 1975: 143). This difference of the spanished from their relatives and friends (Nafzigir 1975: 143). This difference of the spanished by the fact the spanished by spanished financial their relatives and friends (Nafzigir 1975: 143). This difference in their relatives and friends that the scene might have under the sce of it from their explained by the fact that the scene might have undergone and the scene might have undergone aciderable change after bank nationalisation in July 1969. The reason is proved to the scene might have undergone aciderable change is now. direct that the scene might have undergone after bank nationalisation in July 1969. The reason is that considerable change after bank nationalisation in July 1969. The reason is that our purpose oriented lending is now made to replace security-oriented lending is now made to replac purpose-oriented lending is now made to replace security-oriented lending.

the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources used for raising funds determine what is called the sources and the sources used for raising funds determine what is called the sources are sources used for raising funds determine what is called the sources are sources as the sources are sources as the source of the sources are sources as the sources are sources as the source of the sources are sources are sources as the source of the sources are sources are sources as the source of the sources are sources. The sources used for raising funds determine what is called in financial the sources that it is called in financial the sources used for raising funds determine what is called in financial the sources used for raising funds determine what is called in financial The sources that it is called in financial the sources capital structure. The following section 17.3 deals, in detail, with spect. this aspect.

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1/3 CAPITAL STRUCTURE What is capital structure? You have just learnt that an enterprise/business What is the internal and external sources. These take the forms of the capital and borrowed capital respectively. The forms of ownership capital and borrowed capital respectively. The former is also known in and the latter as debt. The composition of cavity sequity and the latter as debt. The composition of equity and debt in overall apital of an enterprise is called 'capital structure.' In simple words, capital of a sister ratio between debt and equity capital. depital of an equity capital. Hence, it is also expressed structure is the ratio between debt and equity capital. Hence, it is also expressed as the debt-equity ratio.

Here, it must be noted that the term capital structure differs from financial gructure. Capital structure means the permanent financing of the enterprise represented primarily by long-term sources of funds, i.e., debt and equity. Thus, representation of the state of to how the firm's assets are financed by raising funds from both long-term and short-term sources.

A business enterprise needs to maintain a proper ratio between these two in order to function smoothly and efficiently. Then, the obvious question arises is what should be the proper, or say, optimum capital structure? In fact, it depends mer alia upon the business conditions of the enterprise concern. As a general principle, for a successful business in favourable conditions, debt capital may be twice or even more than equity capital. But, for a business reeling under unfavourable conditions, say incurring losses, the proportion of debt capital should be as low as possible. This is because on account of fluctuation in earnings and inadequacy of cash, the enterprise may not pay interest and the amount of lan. In consequence, the creditors and suppliers will look upon the financial position of the enterprise as unreliable and, hence, may stop extending credit. Such position will culminate to make the enterprise insolvent.

In simple words, an optimum capital structure can be defined as a financing mix incurring the least cost but yielding the maximum returns. It is obtained when the market value per equity share is the maximum. Ezra Solomon (1969: 1) has defined capital structure in the following words:

"Optimum leverage can be defined as that mix of debt and equity which will Primise the market value of a company, i.e., the aggregate value of the claims and mership interests represented on the credit side of the Balance Sheet. Further, the

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33.3.4 Mergers and Acquisitions (M&A)

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Merger and acquisition are yet other forms of external growth strates.

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Merger means a combination of two or more existing enterprises into one in the strates.

Thus, merger and acquisition enterprises another. Thus, merger and acquisition Merger and acquisition are your more explanation. For the enterprise which acquires another, Thus, merger and acquisition are the the enterprise which acquires another. Thus, merger and acquisition are the the enterprise which acquires another. Merger means a combination of the state of the enterprise which acquires another. Thus, merger and acquisition are the the enterprise which acquires another. Thus, merger and acquisition are the the the thing which is acquired, it is called 'merger. Thus, merger and acquisition are the the thing which is acquired, it is called 'merger. Thus, merger and acquisition are the thing which is acquired, it is called 'merger. Thus, merger and acquisition are the thing which is acquired, it is called 'merger. Thus, merger and acquisition are the thing which is acquired. If both organizations the other terms used for the enterprise which is acquired. If both organization. The other terms used for the enterprise which is acquired to the thing which is acquired to the thing which is acquired to the thing the thing which is acquired to th the enterprise which acquires another the enterprise which acquired it is called merger. Thus, merge the identity to create which is acquired, it is called organizations dissolve their identity to create which is acquired, it is called consolidation. The other terms used for M&A are more popularly in it is called consolidation. which is acquired, it is called in organizations disable terms used for Mean sides of the same coin. If both organization. The other terms used for Mean sides of the same coin. If both organization. M&A are more popularly known new organization, it is called consolidation. M&A are more popularly known new organization, and integration. sides of the same coin. If both mew organization, it is called consolidation. M&A are more popularly known absorption, amalgamation, and integration in three decades after Independence, the normal resulting up new projects. But the projects is a setting up new projects. new organization, it is called and integration. When the popularly known absorption, amalgamation, and integration after Independence, the normal rough as takeovers. For more than three decades after Independence, the normal rough as takeovers. For more than three decades after Independence, the normal rough as takeovers. absorption, amalgamation, and setting up new projects. But the pour of growth was through licensing and setting use of takeover strate of growth was through licensing and setting use of takeover strate. as takeovers. For more than the one of takeovers and setting and setting use of takeover strategy of growth was through licensing and setting use of takeover strategy of growth was through licensing and setting use of takeover of a Cerus, and Pricewaterhouse of a Cerus, and Pricewaterhouse of the original growth. of growth was through the witnessed an Interest of takeover of a Certal liberalization, since 1991, has witnessed an Interest of takeover of a Certal liberalization, since 1991, has witnessed an Interest of takeover of a Certal liberalization, since 1991, has witnessed an Interest of takeover of a Certal liberalization, since 1991, has witnessed an Interest of takeover of a Certal liberalization, since 1991, has witnessed an Interest of takeover of a Certal liberalization, since 1991, has witnessed an Interest of takeover of a Certal liberalization, since 1991, has witnessed and Interest of takeover of a Certal liberalization, since 1991, has witnessed and Interest of takeover of a Certal liberalization, since 1991, has witnessed and Interest of takeover of a Certal liberalization, since 1991, has witnessed and Interest of takeover of a Certal liberalization of takeover liberalization, since 1991, the Mahindra & William and PricewaterhouseCooper as the means or rapid growth. Mahindra & William and PricewaterhouseCooper as the means or rapid growth. Mahindra & William and PricewaterhouseCooper as the means or rapid growth. Mahindra & William and PricewaterhouseCooper as the means or rapid growth. Mahindra & William and PricewaterhouseCooper as the means or rapid growth. Mahindra & William and PricewaterhouseCooper as the means or rapid growth. Mahindra & William and PricewaterhouseCooper as the means or rapid growth. Mahindra & William and PricewaterhouseCooper as the means or rapid growth. Mahindra & William and PricewaterhouseCooper as the means of t as the means or rapid gives takeover of Corus, and RSM. Ambit are illustrative takeover of Mumbai-based taxation company RSM. Ambit are illustrative examples of mergers & acquisitions.

Reasons for Mergers and Acquisitions For a merger to take place, two enterprises or organizations have to apprize and the other is the seller. Both these types For a merger to take place, two enterprises the seller. Both these types on the buyer enterprise and the other is the seller. Both these types of reasons on the basis of which they merge, Follow One is the buyer enterprise and the outer to of which they merge, Following enterprises have a set of reasons on the basis of which they merge, Following are the illustrative ones:

# Reasons for Buyer to Merge:

- (i) To increase the value of the enterprise's stock.
- (ii) To increase the growth rate and make a good investment.
- (iii) To improve the stability of its earnings and sales.
- (iv) To balance, compete or diversify its product line.
- (v) To reduce competition.
- (vi) To acquire a needed resource quickly.
- (vii) To avail tax concessions and benefits.
- (viii) To take advantage of synergy.

## Reasons for Seller to Merge:

- (i) To increase the value of the owner's stock and investment.
- (ii) To increase the growth rate.
- (iii) To acquire resources to stabilize resources.
- (iv) To benefit from the tax legislation.
- (v) To deal with top management succession problem.

# Types of Mergers and Acquisitions

Mergers and acquisitions can be classified into the following types:

1. Horizontal M&A: Horizontal M&A take place when there is a combination of two or more organizations in the same business, or organizations engaged in certain aspects of the production or marketing processes. A footwest

thout joining hands with the popular forms of internal growth strategy is extend the popular forms of internal growth strategy. What is not internal growth strategy enterprises grow by the popular forms of external growth strategy. been the popular forms of internal growth 2 External Growth Strategy What is not life.
2 External Growth Strategy What is not life.
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7 External Growth Str growth strategy. In case of external growth strategy of external growth strategy in case of external growth strategy hands with other enterprises. The popular forms and sub-contracting. 33.3.2 D hands with other enterprises. The popular to and sub-contracting include joint ventures, mergers and acquisitions, and sub-contracting. thide joint ventures, mergers and acquisition to the listed as follows: Diversi Pans 33.3. 1. Expansion 33.3. 2. Diversification the exi 33.3. 3. Joint Venture 33.3. 4. Mergers and Acquisitions 33.3. 5. Sub-Contracting 33.3. 6. Franchising These are now discussed one by one. 3.1 Expansion

Expansion is one of the forms of internal growth of business. It means line of activity. Expansion is a new line of activity. 33.3.1 Expansion Expansion is one of the forms of International Expansion is a natural enlargement or increase in the same line of activity. Expansion is a natural enlargement or increase in the same line of activity. In case of expansion enlargement or increase in the same line of time. In case of expansion growth of business enterprise taking place in course of time. In case of expansion growth of business enterprise taking place in course of time. In case of expansion growth of business enterprise taking place in course of time.

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growth of business enterprise taking place in the enterprise grows its own without joining hands with any other enterprise taking place in the enterprise grows its own without joining hands with any other enterprise taking place in the enterprise enterprise expansion. These are: There are three common forms of business expansion. These are:

- re are three common forms of business. It means the enterprise increases

  1. Expansion Through Market Penetration: It means the enterprise increases. 1. Expansion Through Market Penetration.

  the sales of its existing product by enlarging the existing market. In other words, the sales of its existing product by enlarging roads in the existing market. the sales of its existing product by enlarging the market penetration means making deeper in roads in the existing market. Various market penetration means making deeper in roads in the existing market. The scheme market penetration means making deeper in too an existing market. The scheme for schemes are launched to penetrate into an existing market. The scheme for schemes are launched to penetrate lifto difference and schemes are launched to penetrate lifto difference and scheme are launched to penetrate lifto difference and launched to penetrate lifto difference and lau of market penetration.
- 2. Expansion Through Market Development: It implies exploring new markets for the existing product. In order to increase the sale of existing product, the enterprise makes searches for new customers.
- 3. Expansion Through Product Development and/or Modification: It implies developing or modifying the existing product to meet the requirements of



aractual agrees arradal econom (m) Diversification adds to the competitive strength of the business defined joint (iii) Diversification adds to the compensation to tide over business flu
 (iv) Diversification also enables an enterprise to tide over business flu district or inc and, thus, ensures amouth running of the business. of sountry in (ne) Diversification also enable running of the and, thus, ensures smooth running of the and the analysis and the analysi statment amo of venture is Disadvantages: All is not go rtain disadvantages.

(i) Diversification involves business reorganization which requires adda.

(ii) Diversification involves business reorganization which requires adda.

(iii) Diversification involves business reorganization which requires adda. Diversification involves business recomes a costly proposition resources. Thus, diversification becomes a costly proposition. certain disadvantages. other into agree (i) Diversification involves interesting the present of the prese of the to an en (ii) It becomes difficult, is the diverse business. the diverse business. There is no uniform type of diversification adoption of Diversification: There is no uniform type of diversification. Types of Diversification and Diversification of D Seventures pa the diverse business. There is no uniform types of Diversification: There is no uniform types of Diversification: There is no uniform types of Diversification: There is no uniform types of Diversification adopted by all enterprises. It varies from enterprise to enterprise. Usually, diversification by all enterprises. the profits or and in the abs the Parties. In is of four types: goods from o 1. Horizontal Diversification anderwriting 2. Vertical Diversification 3. Concentric Diversification, and conditions 4. Conglomerate Diversification A brief description of these follows: A brief description of these follows:

A brief description of these follows:

I. Horizontal Diversification: In this type of diversification, the same to be added to the existing ones. Adding refrigerators to be added to the existing ones. Joint ver L. Horizontal Diversification: In this type

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of product or market added to the existing ones. Adding refrigerators to the product or market added to the existing ones. Adding refrigerators to the product of product or market added to the existing ones. Adding refrigerators to the product of product or market added to the existing ones. Adding refrigerators to the product of product or market added to the existing ones. Adding refrigerators to the product of product or market added to the existing ones. Adding refrigerators to the product of product or market added to the existing ones. Adding refrigerators to the product of product or market added to the existing ones. Adding refrigerators to the product of product or market added to the existing ones. anditions, of product or market added to the existing of product or market adde (i) Whe (ii) Whe versification.

2. Vertical Diversification: In this type of diversification, complementary added to the existing product or service line of the existing product or s Diversification. 2. Vertical Diversification: In this type
products or services are added to the existing product or service line of the products or services serve either as inputs or a custom products or services are added to the existing in the enterprise. The new products or services serve either as inputs or a customer for enterprise. The new products or services serve either as inputs or a customer for enterprise. (iii) Wh enterprise. The new products or services service the firm's own product. A T.V. manufacture to the firm's own product. A T.V. manufacture to the needed by it. Similarly, a sugar mill may develop a sugarcane farm to supply needed by it. Softing up of retail shops by companies like a possible and the supply state of needed by it. Similarly, a sugar min may a raw material or inputs for it. Setting up of retail shops by companies like Delhi raw material or inputs for its also vertical type of diversification. Cloth Mills to sell its fabrics is also vertical type of diversification. 3. Concentric Diversification: In case of concentric type of diversification. 3. Concentric Diversification. In case an enterprise enters into the business related to its present one in terms of an enterprise enters into the business technology, marketing or both. Nestle, originally, a baby food producers entered technology, marketing or both. Nestle, originally, a baby food producers entered technology, marketing or both. Nestle, originally, a baby food producers entered technology. business technology, marketing or both. Ivestic, organization and 'Maggi Noodles'. Similarly, a into related products like 'Tomato Ketchup' and 'Maggi Noodles'. Similarly, a tea company like Lipton may diversify into coffee. 4. Conglomerate Diversification: This type of diversification is just contrary to concentric diversification. In this type of growth strategy, an enterprise diversifies into the business that is not related to its existing business neither in terms of technology nor marketing. JVG carrying on business in newspaper and detergent cake and powder, Godrej manufacturing steel safes and shaving cream are examples of conglomerate diversification.

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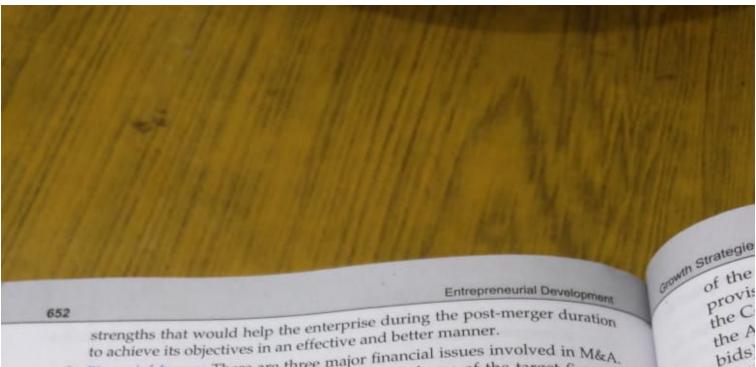
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### 33.3.3 Joint Venture

Joint venture is a type of external growth strategy adopted by business firms. A joint venture could be considered as an entity resulting from a long-term



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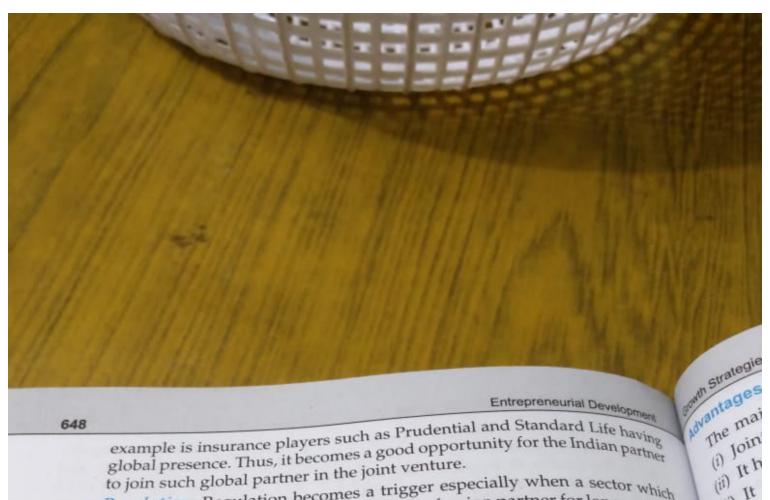
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- 2. Financial Issues: There are three major financial issues involved in M&A. These are: (i) valuation of the business and shares of the target firm; (ii) sources of financing for mergers; and (iii) taxation matters after M&A. The valuation of the business of the target firm is a detailed and comprehensive process that should take into account a range of factors including the tangible and intangible assets, the industry profile of the firm and its prospects and the future earnings and prospects of the target firm. Similarly, the valuation of the shares in an M&A is equally complicated process involving issues such as the stock exchange price of the shares of the target firm, dividends paid, growth prospects of the firm, value of its assets, quality and integrity of the top management, competitive conditions, opportunity costs in terms of investments and market sentiments. The second financial issue is of the sources of financing required for enterprises involved in M&A. Several sources of funds available range from the acquiring companies' own funds or borrowed funds, raised through the issue of debentures, bonds, deposits, external commercial borrowings, global depositary receipts, loans from Central or State financial institutions or rehabilitation finance provide to sick industrial companies. The third issue is of the taxation matters that are dealt with under the relevant provisions of the Income Tax Act, 1961, and which are related to various technical aspects such as the carrying forward or set-off of losses and unabsorbed depreciation, capital gains, tax and amortization of expenses.
- 3. Managerial Issues: These issues relate to the umpteen problems of managing enterprises after the M&A has taken place. It is important to note that the perception of how the management will take place after M&A also matters and affects the process involved in it. The usual experience is that the post M&A is characterized by changes in staff, specially chief executives and top mangers. If there is an assurance that the merger will lead to a status quo, or that 'professional management' would be adopted



example is insurance players such as Prudential and Standard Life having example is insurance players such as I to global presence. Thus, it becomes a good opportunity for the Indian partner global presence. Thus, it becomes a good opportunity for the Indian partner to join such global partner in the joint venture.

(iii) It

(iv)

nisa

• Regulation: Regulation becomes a trigger especially when a sector which Regulation: Regulation becomes a trigger of the sector which was highly restricted and closed sector for foreign partner for long period is was highly restricted and closed sector in India is one such example now opened up. Here again, insurance sector in India is one such example now opened up. Here again, insurance players. It is due to this regulatory which was recently opened for foreign players. It is due to this regulatory which was recently opened for 101 of 1 and Indian Credit and Investment change the Indian partners like Bajaj and Indian Credit and Investment Corporation of India (ICICI) joined foreign players in joint ventures in the

- Sharing of Risk and Capital: This includes capital-intensive sectors like heavy-engineering requiring highly sophisticated technological expertise, In such cases, both the partners involved in joint venture share risks and capital equally to effectively run the venture.
- Intellectual Exchange: Legal business could be such sector where both the partners gain intellectual advantage irrespective of law on the entry of foreign law firms in one country.

### pes of Joint Ventures

Experience suggests that joint venture is especially useful for entering ernational markets. As such, an Indian organization can enter a foreign market joint venture with a foreign organization. Similarly, a foreign firm can also r into a joint venture with an Indian organization. From the point of vi ndian organizations, the following five types of joint ventures are poss

# **How Mergers and Acquisitions Take Place?**

company, i.e. M&A organizations.

M&A can take place in various ways. There is no specific and standard procedure available for M&A to take place. However, based on experiences relating to M&A, it is realized that following certain guidelines can be useful for M&As to take place systematically. The major steps include but are not limited to the following only:

- · Spell out the objective
- Indicate how the objective would be achieved
- Assess managerial quality
- Check the compatibility of business styles
- Anticipate and solve problems early
- Treat people with dignity and concern

# 33.3.5 Sub-Contracting

# What is Sub-Contracting System?

Sub-contracting system is a mutually beneficial commercial relationshi between the two companies. This is known as Ancilliarization in India as more generally as 'sub-contracting.' Sub-contracting can be defined as follow

A sub-contracting relationship exists when a company (called a contract places an order with another company (called the sub-contractee) for omponents, sub-assemblies or assemblies to be incorpo rders may include the proce

paragram in Straight and the straight and the straight and straight an omprizontal M&A only algorization of the policy of supply of materials (say materials company to the same business, come together to create organizations, not ported MEA: In vertical NeA, two or more organizations, not example the same business, come together to create complementarities of the same outputs). For example, phase or marketing of marketing of the same business, come together more organizations, real parameters of supply of materials (say material) complementarities either process of supply of materials complementarities either process of the supply of sup in terms (say outputs). For example, pharmacounties of processis medical store.

This refers to two or more company combines of grade and store of the refers to two or more company combines. h strategy o one For with retail med. This refers to two or more organizations related to each of the company combines of the combi enterprise with the strice Merch to the control of the control re the two combine together. For example, a footwear company combines with a o create a M&A are ly known consiery firm the most open the company combines with a considered of concentric M&A. In this case, or functions or alternative test, to each other cut. mal route constraint or an interest of concentric M&A. In this case, to mer functions or alternative technologies. Combined in terms of the postor more of the company and footwear company is one street are already discompany is one of the company and footwear company is one street are already discompany is one street. strategies one types are already discussed under the such example. a German pharmace four types are already discussed under "Types of Diversification". Coopers's these are not discussed here again to avoid repetition.

Mergers and acquisitions provide the department of the provide the second repetition. llustrative these are Mergers and acquisitions provide the following advantages:

Advantage: Mergers and acquisitions provide the following advantages: provide benefits of economies of scale in terms of production and sales. Facilitate better use of resources. ve to act Enable sick enterprises to merger into the healthy ones, promote diversification in product line to take types of Enable by Enable diversification in product line to take advantages of opportunities available in the particular business. following prolition product line particular business. pisadvantages: Mergers and acquisitions are not unmixed blessings. These pisate from the following drawbacks: (i) Larger scale operations often make co-ordination and control ineffective.

(ii) This adversely affects business performance as a whole Larger This adversely affects business performance as a whole. Sometimes mergers and acquisitions lead to monopoly in the particular lusiness. Monopoly is not welcome in the interest of the business. Monopoly is not welcome in the interest of the society. mportant Issues Involved in Mergers and Acquisitions Mergers and acquisitions involve margers and acquisitions involve Mergers and acquisitions involve expertise in special areas such Meaning in special areas such accounting, finance and legal matters and negotiations. Following are some important strategic, financial managerial and a special areas such important strategic, financial managerial and a special areas such important strategic. the important strategic, financial, managerial, and legal issues involved in 1. Strategic Issues: These issues relate to the commonality of strategic interests nergers and acquisitions: between the buyer and seller firms. The main objective of M&A is to create synergetic effects for the enterprises. Therefore, the strategic advantages and distinctive competencies due to M&A for the merging enterprises have to be duly examined and analysed. It is also important to note that there has to be a fine match between the objectives of the firms involved in M&A. For example, a merger should ideally lead to the generation of sufficient bination engaged footwear

contracting system in the industrial world. Japan is considered the birth place of contracting system in the industrial world. Japan, when military demand for maching of contracting system in the industrial world. Japan, when military demand for machinery modern sub-contracting system. In Japan, when military demand for machinery modern sub-contracting system. In Japan, when military demand for machinery modern sub-contracting system. In Japan, which have firm could not meet the industry expended enormously during 1930s, the large firm could not meet the industry expended enormously during 1930s, Industry could not meet the ever huge orders. In 1938, Mitsubishi Heavy Industry could not meet order ever huge orders. In 1938, Mitsubishi Heavy Industry could not meet the ever huge orders. ever huge orders. In 1938, Mitsubishi Heavy capacity, for example. Increasing equivalent to over its two years' production capacity, for example. Increasing equivalent to over its two years' production capacity, for example. Increasing equivalent to over its two years' productions in the capacity industries had crucial importance in the capacity industries had crucial ind equivalent to over its two years' production that the equivalent to over its two years' production capacity of heavy machinery industries had crucial importance in the production capacity of heavy machinery industries had crucial importance in the production capacity of heavy machinery industrial small enterprises and cottage Japanese economies. As per the need of the hour, small enterprises and cottage Japanese economies. As per the need of the large machinery firms to make industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries shifted their production to support the large machinery firms to ment industries and the ment industri industries shifted their production to support their orders. In view of poor technological knowledge of small enterprises, a their orders. In view of poor technological knowledge of small enterprises, a their orders. In view of poor technological structure was introduced to make new relationship known as Sub-contracting System was introduced to make new relationship known as Sub-contracting of make long-term and direct trade relations between small and large industries, instead long-term and direct trade relations between small and large industries, instead long-term and direct trade relations between by the brokers. Today, the key of floating and short -term relations mediated by the brokers. Today, the key of floating and short -term relations in this sub-contracting system only. As a to so many small firms in Japan lies in this sub-contracting system only. As a to so many small firms in Japan lies in the character of the Japanese matter of fact, sub-contracting has become basic to the character of the Japanese matter of fact, sub-contracting has become facturing companies (having less than industries. 56 per cent of the small manufacturing system. In Indian lands than the state of the small manufacturing system. In Indian lands than the state of the small manufacturing system. 300 employees) are producing under sub-contracting system. In India, Subcontracting has emerged in the name of ancillarsation or 'ancillary units'

We have only mentioned the historical background of sub-contracting system in the industrial economy of Japan. The real role of sub-contracting can perhaps be clearly seen by juxtaposing of its advantages and disadvantages to small-scale enterprises. To this we turn in the following paragraphs:

Advantages: Sub-contracting system bears the following advantages.

- (i) It increases production in the fastest way without making many efforts.
- (ii) The contractor can produce products without investing in plant and machinery.
- (iii) Sub-contracting is particularly suitable to manufacture goods temporarily,
- (iv) It enables the contractor to make use of technical and managerial abilities of sub-contractors.
- (v) Despite leading to dependence, sub-contracting ensures existence of Subcontractors by providing them business.
- (vi) Last but no means the least; sub-contracting makes the core firms more flexible in their production.

Disadvantages: However, sub-contracting has some disadvantages also. These are:

- (i) It does not ensure the regular and uninterrupted supply of goods to the core firms, i.e. contractors which adversely affect the functioning of the core firms.
- (ii) Goods produced under Sub-contracting system are often qualitatively
- (iii) Sub-contracting also delimits the expansion and diversification of the core firms.
- (iv) A delay in payments, a common feature, by the contractor to the subcontractors endangers the very survival of the latter.

Strategies in Small-Sca gundontracting or Ang In mennt support s

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amortization of expenses.

3. Managerial Issues: These issues relate to the umpteen problems of the M&A has taken place. It is important. Managerial Issues: These issues relate to the M&A has taken place. It is important to managing enterprises after the M&A has taken place. It is important to managing enterprises after the M&A has the place after M&A note that the perception of how the management will take place after M&A note that the perception of how the manager in it. The usual experience also matters and affects the process involved in it. The usual experience also matters and affects the process involved in staff, specially chief is that the post M&A is characterized by changes in staff, specially chief is that the post M&A is characterized by the chief executives and top mangers. If there is an assurance that the merger will executives and top mangers. If there is all the executives and top mangers. If there is all the executives and top mangers. If there is all the executives and top mangers. If there is all the executives and top mangers. If there is all the executives and top mangers. If there is all the executives and top mangers. If there is all the executives and top mangers. If there is all the executives and top mangers. If there is all the executives and top mangers. If there is all the executives and top mangers. If there is all the executives and top mangers. If there is all the executives and top mangers. If there is all the executives are all the executives and the executive executives are all the executives and the executive executives are all the executives and the executive executives are all the executives are all the executives and the executive executives are all the executive executives are all the executive executives are all the executive executives and the executive executive executives are all the executi lead to a status quo, or that 'professional fitted, then the M&A process may take place smoothly. On the contrary, if the then the M&A process may take place of the the M&A process may take place of the M&A is perceived as threatening, it results in resistance and opposition by M&A is perceived as threatening, it reduces the post-merger period poses the various groups. This happens because the post-merger period poses the various groups. This happens because organizations. The reason is that they feel insecure about their job, status within the organization, and that they reel insecure about their jobs their earnings and promotional prospects. The consequence of feeling threatened by the impending changes due to M&A, the existing managers oppose change which, in turn, leads to low morale and productivity and often resulting in mass exodus of managers from the organization.

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4. Legal Issues: These issues relate to the provisions made in law for the purpose of M&A. In India, the provisions relating to M&A and other schemes are contained in Chapter V of the Companies Act, 1956 and specifically, in Sections 391 to 395 of the Companies Act, 1956 and in the rules 67 to 87 of the Companies (Court) Rules, 1959. The implementation

