Share Swap Ratios

At least seven of the **10 public sector banks slated for merger** have invited independent experts to determine their share swap ratios.

- When a company pays for acquisition by issuing its own shares to the shareholders of the target company, this is known as a share swap. The number of shares to be issued in lieu of their existing holdings in the target company is called the Share Swap Ratio.
    - It is determined by valuing the target company after looking into metrics such as its revenues and profits, as well as its market price.
    - If the target company is listed, the market value of its shares is often a key consideration to arrive at the right price to be paid.
- A swap ratio also brings to light many aspects of Mergers and acquisitions transaction between the two companies.
    - Firstly, it shows the relative size and strength of both companies. In general, if more shares of the target company are exchanged for one share in the acquiring company, then the latter is likely to be bigger and stronger.
    - Secondly, it determines the control that each set of shareholders has on the combined company. For example, the acquiring company may have greater control over the firm if the swap ratio is high and, therefore, its Board of Directors could have a larger share in the new Board.

Objective

- **Confidence to Investors:** A swap ratio's rationale is to give the same amount of confidence to investors even after the merger or acquisition goes through.
- **Maintain Equilibrium:** The swap ratio is kept reasonable to maintain an equilibrium between the investors of both companies. No merger or acquisition should result in an unfair transfer of wealth from one group to another, so the swap ratio is calculated after taking into account many financial factors of both companies.

Advantages

- **Lower Risks:** As shareholders of the target company will also be shareholders of the merged entity, the risks and benefits of the expected synergy from the merger is shared by both the parties.
- **Non Taxable:** In case of a share swap, when shareholders of the acquired company are given shares of the acquirer company as part of the deal, it is **not considered a transfer** of shares. Hence, **capital gains tax will not arise**.

  The tax liability will arise only when the shares of the merged entity are sold.

Source: livemint