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Hostile Takeovers: Emerging Trends

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Introduction

There was a merger and acquisition boom in India and since liberalization India has experienced a number of Hostile takeover attempts. Hostile takeover of companies is a rather well-known phenomenon in the corporate sphere. Since liberalization corporate takeover has taken two forms – friendly and hostile. In a friendly takeover, the controlling group sells its controlling shares to another group of its own accord. In a hostile takeover, an outside group launches a hostile attack to take over the control of the company without the concurrence of the existing controlling group. This is normally done by means of an open offer for purchase of equity shares from the shareholder of the target company. From past few years, India has experienced a number of hostile takeovers attempts conventional wisdom suggests that hostile takeovers by foreign enterprises will not occur in India because of three following reasons: -

(i) There is controlling of shareholders in Indian corporations;

(ii) There is necessity of governments approval for foreign acquisitions that would make hostile takeover impossible;

(iii) Provisions of takeover code which favours existing controlling shareholders;

But when we see the past few years, we can say that Hostile takeovers have finally arrived in India and family run business houses are scurrying for cover. India's Industrial scions have been shaken out of their slumber and suddenly find themselves vulnerable against relatively new and young raiders. Since 1994, when SEBI framed Takeover Regulation, there have been no successful hostile takeovers, but in the past few years it certainly seems to be in growth and it may not be long before inefficient management coupled with low stock prices make them attractive prey for a hostile bidder.

Hostile Takeover: A Brief Conceptual Explanation

A takeover takes place when one company acquires control of another company, usually a smaller company than the first company. It may be defined as a transaction or series of transactions whereby a person (individual, group of individuals or a

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company) acquires control over the assets of another company, either directly by becoming the owner of those assets or indirectly by obtaining the control of the management of the company.[1] The company, which acquires control of another company, is called the 'acquirer' (offeror) whereas the company, which is acquired, is called the 'target' (offeree). In a case where shares are closely held (i.e., held by a small number of persons) a takeover will generally be affected by agreement with the holders of the majority of the share capital of the company being acquired. Where the shares are held by the public generally, the takeover may be affected:[2]

1. By an agreement between the acquirer and the controllers of the acquired company;

2. By purchases of shares on the stock exchange; or

3. By means of a "takeover bid".

A takeover bid is a technique for affecting a takeover or a merger[3]: in the case of a takeover, the bid is frequently against the wishes of the management of the target company; in the case of a merger, the bid is generally by consent of the management of both companies. It may be defined as an offer to acquire shares of a company whose shares are not closely held (dispersed shareholding), addressed to the general body of shareholders with a view to obtaining at least sufficient shares to give the offeror voting control of the company.

A takeover bid may be undertaken in the form of an offer to purchase shares for cash or of a share-for-share exchange or of a combination of those two forms. In other words, the consideration part in a takeover bid may be cash, or shares/debentures of the acquiring company, or the shares of a third company, which has nothing to do with the takeover.[4]

History of Hostile Takeover Activity In India

The concept of takeover without consent termed as hostile takeover. No consented history of hostile takeover can be traced to the 1980s with the U.S Supreme Court

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[1] Weinberg and Blank. *Takeovers and Mergers* (London: Sweet and Maxwell, 1999) Vol. 1 at 1005.

[2] Id.

[3] The distinction between a 'takeover' and a 'merger' is that in a takeover the direct/indirect control over the assets of the acquired company passes to the acquirer, in a merger the shareholding in the combined company will be spread between the shareholders of the two companies. Often the distinction is a question of degree.

[4] according to the recommendation of Bhagwati Committee on Takeover that the acquirer should be permitted to offer shares of the third company as consideration for shares tendered. This is essentially to increase the flexibility available to the acquirer in funding the offer.

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for the first time sat in judgment over the anti-takeover provisions of the Illinois Business Takeover Act and pronounced them as invalid in landmark ruling in Edgar vs. MITE Corp. Hostile takeovers occur rarely even in the most mature economies, so it then should not be surprising that in India, where the economy was only liberalized in 1991, a mere dozen or so hostile takeovers have been attempted. The four cases illustrated below are meant to provide historical context to the current situation and illustrate some of the political and technical barriers that a foreign hostile acquirer might face today.

Swaraj Paul's failed bids for escorts and DCM

In 1984, long before the liberalization of the Indian economy or the promulgation of the Takeover Code, British businessman Swaraj Paul attempted to unilaterally take control of two Indian corporations, Escorts Limited and DCM. Although he accumulates roughly 7.5% and 13% stakes in Escorts and DCM, respectively, more than the promoters of each corporation, the two companies registered his takeover attempt and each refused to register Paul's newly purchased shares, thereby technically blocking the transaction.[5] The controlling families used their political clout to cause problems for Paul, despite his personal ties to Prime Minister Indira Gandhi. Paul was also opposed by the life Insurance Corporation of India, a state – owned financial Institution that held a minority stake in the companies. Paul finally retracted his bid. While he was ultimately unsuccessful, Paul's hostile threat sent shockwaves through the otherwise complacent Indian business world.

Today, the ability of a target company to refuse to register shares is highly constrained. Following an amendment to the companies Act providing for free transferability of shares, the Indian courts have ruled refusal to register shares may only be undertaken if the transfer is found to be in violation of law.[6]

Asian paints / ICI

Nearly 15 years after Swaraj Paul's failed hostile bids, the Indian government and business community were still not prepared to accept a hostile foreign acquisition. ICI, a paints company headquartered in the U.K., had agreed with Atul Chosky, the managing director and co-founder of the Indian paint company, Asian paints, to purchase his 9.1% stake.[7] His three other co-founders, however, opposed his sale to

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[5] See John Elliott, International Companies and Finance: India Gives Green Light to Paul Share Deals, FINANCIAL TIMES (UK), September 20, 1983; Mahesh Kumar Tambi, *Indian Takeover code : In Search of Excellence (A case study approach),* available at : http://econpapers .repec.org/paper/wpawuwpma/0504021.htm.

[6] Section 111A of the companies Act is the new section allowing for free transferability of shares.

[7] India Rejects ICI Bid for stake in Asian Paints, Ltd., *Asia Pulse*, November 3, 1997.

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a foreign party, and threatened to refuse to register ICI's shares in the same fashion as Escorts and DCM. Ultimately, the government of India, through its Foreign Investment Promotion Board, (FIPB) thwarted the bid, ruling that foreign acquirers taking control of an Indian company needed to first obtain board approval.[8] This was peculiar, given that the remaining co-founders together retained well above ICI's 9.1% stake and hence would maintain control over the company. Without the support of the other three founders, however, the deal failed to win board approval, and was ultimately abandoned.[9]

According to a leading investment banker I interviewed, the FIPB was influenced by significant political lobbying in this situation. As will be discussed in the next section, government approval of most foreign takeovers today only involves enforcement of sectoral FDI limits. Of course, a government keen to block a foreign takeover may find ways outside of the formal regulatory structure to scuttle such a bid.[10]

India cements / Raasi cements

The only hostile takeover in Indian history resulting in ultimate acquisition of the target by the hostile bidder occurred in 1998 when BV Raju sold his 32% stake in Raasi cements to India cements.[11] India Cements made an open offer for Raasi shares, and it acquired roughly 20% on the open market,[12] but faced resistance from the founders of Raasi as well as the Indian financial institutions which also owned substantial stakes in the firm. However, following a protracted battle which involved press conferences featuring the children and grandchildren of the founding family protesting the hostile bid, Raju ultimately sold out to India cements in a privately negotiated transaction.

Gesco

The Dalmia group's purchase and sale of its 10% stake in the real estate firm GESCO for an approximately 125% premium in 2000 is the closest India has come

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[8] Id

[9] id

[10] See heather Timmons, Marketplace : Nations Rebuild Barriers to Deals, N.Y. Times, February 28, 2006, section C (discussing increasing pattern of protectionism by U.S. and European politicians including the U.S. political outcry in response to proposed acquisitions by CNOOC and Dubai ports and the French political response to the acquisition of Arcelor by Mittal steel).

[11] ICL succeeds in Raasi Cements Takeover, Statesman (Kolkata), April 6, 1998.

[12] This preceded the current Takeover code, which would have required a mandatory open offer after crossing the 15% threshold.

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to greenmail.[13] This hostile bid, for 45% of the company, was only averted thanks to a white knight recruited by the founding Sheth family, the Mahindra group, which offered to buy-out the entire remaining float for an even higher premium.[14] After an intense bidding war that drove the initial offer price up roughly 100%, the Mahindra-Sheth group agreed to buyout the Dalmias' 10% stake.[15]

Recent Cases of Hostile Takeover Bids

Kraft Foods Madea $ 16.3 billion in Nov. 09 for British candy maker Cadbury. In May 2010 Pepsi Company tried to acquire Pepsi America Inc. and recently Roche, Samsung and In Bev tried their hands at takeover as well. In fact, hostile takeover actually makes up over 10% of Merger and Acquisition activity in the past one year that means vultures are feasting.

In 2012, Essel Group's Subhash Chandra sought to control Iragavarapu Venkata Reddy Construction Limited (IVRCL), an infrastructure company. The promoters in the target company had only 11.2 per cent stake in IVRCL. Subhash Chandra's Essel Group after acquiring 10.7 per cent stake in IVRCl, made a U-turn and decided to exit its shareholdings in the target company.

Larsen and Toubro Ltd (L&T) gained a controlling interest in Mindtree Ltd, raising its stake to 60% in the Bengaluru-based company on Wednesday and successfully concluding India's first hostile takeover of a software developer.[16]

L&T completed buying the 31% additional stake it targeted to acquire in Mindtree for □4,988.82 crore through an open offer as large investors rushed to sell their holdings.

Restriction imposed on Hostile Takeovers

The Takeover Code is applicable to both friendly and hostile acquisitions. The acquirer may, after negotiations with the shareholders enter into an agreement for purchase of shares of the target company. Such an agreement should contain a

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[13] Greenmail refers to a tactic that gained notoriety in the U.S. in the 1980s where a raider buys up a significant stake in a target company, threatens to launch a hostile takeover, and then accepts a substantial above-market premium to sell back this stake in a privately negotiated transaction with the company. See generally, Jonathan Macey and Fred McChesney, A Theoretical Analysis of Corporate Greenmail, 95 YALE L.J. 13 (1985).

[14] C.R.L. Narasimhan, Greenmail : *Winners and Losers – the GESCO Takeover Battle,* Hindu (India), January 10, 2001.

[15] Id.

[16] news report published on 27 June 2019 Mint

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clause regarding compliance of the provisions of the Takeover Code. Under the Takeover Code, the board of directors of the target company is under a fiduciary responsibility to the shareholders and may send their unbiased comments and recommendations on the offers to the shareholders. For this purpose, they have to seek the opinion of an independent merchant banker or a Committee of Independent Directors. Certain restrictions are imposed on the board of directors of a company under the Takeover Code. The board of directors of the target company are not to, without the prior consent of the Shareholders, sell, transfer, encumber or otherwise dispose or agree to sell, transfer or dispose off assets of the company; or issue or allot any authorized but unissued securities carrying voting rights during the offer period and enter into any material contracts. Once the public announcement has been made, the board of directors of the target company cannot appoint as additional director or fill in any casual vacancy on the board of directors, by any persons representing or having interest in the acquirer, till the date of certification by the merchant banker and shall not allow any person or persons representing or having interest in the acquirer, if he is already a director on the board of the target company before the date of the public announcement, to participate in any matter relating to the offer, including any preparatory steps leading thereto. The board of directors of the target company is required to furnish to the acquirer, within seven days of the public announcement, a list of shareholders or warrant holders or convertible debenture holders who are eligible for participation. It should contain the names, addresses, shareholding and folio number, and shall contain the names of those persons whose applications for registration of transfer of shares are pending with the company. The board of directors of the target company shall facilitate the acquirer in verification of securities tendered for acceptance. Upon fulfillment of all obligations by the acquirers under the Regulations as certified by the merchant banker, the board of directors of the target company shall transfer the securities acquired by the acquirer, whether under the agreement or from open market purchases, in the name of the acquirer and/or allow such changes in the board of directors as would give the acquirer representation on the board or control over the company. The board of directors is also responsible to transfer the securities of the company in the name of the acquirer on successful completion of the acquisition. The board of directors of the merging or amalgamating companies has to firstly approve the scheme before making an application to the High Court seeking directions to convene a meeting. The board of directors of the respective merging companies also has to authorize a director or other officer to make an application and petition to the High Court. The board is also responsible for other statutory compliances in relation to convening of the shareholders meeting. Under a friendly acquisition, an agreement or memorandum of understanding may be entered into by the acquirer and the shareholders of the target company regarding price subject to the guidelines stipulated under the Takeover Code regarding the minimum offer price. This may

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not be possible under a hostile transaction. Under both friendly as well as hostile transaction, the provisions of the Takeover Code are to be complied with except that in case where the acquirer has entered into an agreement for acquisition of shares with the shareholders of the target company, the Letter of Offer is only required to be submitted to the shareholders other than with whom such an agreement has been entered into.

Defences to Hostile Takeovers

In a takeover battle if the board/management chooses to reject a bid it may have to take effective defensive measures in order to stall the raider from carrying out the takeover operation. These defense mechanisms may be put in place after the bid has been made or may have been there prior to the bid having been made. The most obvious case for defense is that by rejecting an initial bid, the board may be seeking to receive a higher offer or inviting a competitive bidder. By mounting a vigorous defense, the board may be able to fetch a better price for surrendering its stake in the target. Defense may also be raised on the ground that the company's net worth is much more than the bidder had calculated. This may be the case when the management of the target company has some privileged and commercially sensitive information, which, if released, would increase the market value of the firm. By mounting such a defense, management may be able to increase the market value of the target firm to such an extent that the bid fails, or, even if the bid succeeds, secure a higher price for their shareholders. Another reason for mounting a defense may be the management's genuine belief that the company is better off by remaining an independent entity.

Finally, the acceptability or rejection of a takeover bid and the extent of its regulation also depends upon the social and political philosophy of a country. For example, in the UK the accountability of management to the shareholders is paramount. The companies are expected to pay out a large proportion of their earnings as dividend payments in order to avert the threat of a hostile bid and they frequently cite the takeover threat as a serious impediment to investing, particularly, in R&D related projects.

On the other hand, companies in other EU countries are not so shareholder-centric. Shareholders are clearly one interest group, but many others exist: workers, the existing management, suppliers, providers of finance other than shareholders (like banks and financial institutions), and other related companies. Such groups are often referred to as stakeholders in a company – those who are involved in the day-to-day operations and who in most EU countries have a right to play a part in the process of running and controlling the company. Of course, in a country like India where an active market for corporate control is still to develop, the question of corporate

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accountability either to shareholders or to other stakeholders has hardly received any significance worth mentioning. In the pre-liberalization era, India's giant industrial houses, most of them family-controlled, enjoyed the government-conferred monopoly status upon them and they hardly bothered to increase shareholder value. Equally guilty have been Indian banks and financial institutions, which held substantial stake in large public companies but they largely remained passive onlookers and never questioned management/board's decision even if the decision went against their own interests as a shareholder in the company. Post-liberalization era, due to increasing competition from foreign and some new aggressive domestic players, has brought about some welcome changes in the area of corporate accountability. A healthy return to shareholders is increasingly being recognized as an important benchmark of corporate success. Therefore, in India it is highly desirable that a healthy market for corporate control is allowed to develop.

Defense Strategies to Takeover Bids

A hostile bid made straightforwardly to the shareholders of the target company with or without past suggestions to the administration of the company has become a method for making corporate blends. Henceforth, there has been extensive premium in creating guard systems by genuine and possible targets. Safeguards can appear as invigorating oneself, i.e., making the company less alluring to takeover offers or harder to take over and, in this manner, debilitate any offers being made. Protective activities are likewise turned to in case of apparent danger to the company going from early knowledge that an acquirer is gathering shares.

Case Study:

The Story Behind the L&T- Mindtree Takeover Bid

The Indian stock market is abuzz with the news of a hostile takeover. Larsen and Toubro, which is one of the largest and the most iconic information technology firms in the country is trying to forcefully acquire Mindtree which is a medium-sized information technology company. The news is abuzz about how Mindtree promoters do not want to sell to L&T and how L&T is trying every trick in the book to acquire this company.

Prima-facie, the L&T Mindtree takeover seems to be fuelled by the same greed that most hostile takeovers are fuelled with. However, it is also a perfect case study about how regulatory actions indirectly affect the business of all firms working in the industry. The reality is that the Mindtree acquisition bid has less to do with the

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attractiveness of Mindtree as a target. Instead, this bid is being driven more by the internal conditions which are being faced by L&T, **with this case studies we get to know the internal conditions as well as the regulatory factors which prompted L&T to launch this unsolicited hostile takeover bid.**