CHAPTER

6 Takeover Strategies and Practices

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MEANING AND CONCEPT

In the previous Chapter, we have discussed the provisions of law relating to M&As. Although the said legal provisions include corporate takeovers, yet there are several other aspects with respect to takeovers which need to be examined separately. Thus, this chapter aims at exclusively dealing with laws, practices and procedures relating to takeovers and its illustrations through case studies.

Takeover implies acquisition of control of a company. This concept emerged in late nineteenth century in some countries like USA, UK etc, when the M&As started. However, it started in India in the twentieth century. According to M.A. Weinberg[i], "takeover is a transaction or series of transactions whereby a person or individual or group of individuals or company acquirers control over the assets of a company, either directly by becoming the owner of those assets or indirectly by obtaining control of the management of the company. In case of companies whose shares are closely held (by a small number of persons), a takeover will generally be affected by arrangement with the holders of the majority of the shares capital of the company which is being acquired. Where the shares are held by the public, the takeover may be affected (1) by agreement between the acquirer and the controllers of the acquired company; (2) by purchase of shares on the stock exchange; or (3) by means of a take-over bid.

Takeover implies acquisition of control of a company, which is already registered, through the purchase or exchange of shares. Takeover takes place usually by acquisition or purchase from the shareholders of a company, their shares at a specified price to the extent of at least controlling interest in order to gain control of that company. Takeover of management and control of a business enterprise could take place in different modes. The management of a company may be acquired by acquiring the majority stake in the share capital of a company. The acquisition could take place through different methods. A person may acquire the voting shares of a listed company through what is known as the takeover by complying with the regulations meant for such purposes. A company may acquire shares of an unlisted company through what is called the acquisition under sections 235 and 236 of the Companies Act, 2013. Where the shares of the company are closely held by a small number of persons, a takeover may be effected by agreement with the holders of those shares. However, where the shares of a company are widely held by the general public, it involves the process as set out in the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011.[(ii) & (iii)]

Why Takeovers?

Berkovitch & Narayanan, (1993) gives a lucid explanation regarding pattern of gains related to takeovers as given in the following table.

TABLE 6.1: PATTERN OF GAINS RELATED TO TAKEOVER THEORIES

	Type	*1* *Total Value*	*2* *Gains to Target*	*3* *Gains to Acquirer*
1.	Efficiency or synergy	+	+	+
2.	Hubris (Winners curse overpay)	0	+	-
3.	Agency problems and mistakes	-	+	-

The first category is synergy or efficiency in which total value from the combination is greater than the sum of the values of the component entities operating independently. Hubris refers to acquiring firm managers commit errors of over estimating the merger gains (due to excessive pride, animal spirits, and the like) and end up paying too high a price for the takeover. It postulates that the value is unchanged. The third class of mergers and takeovers comprise those in which total value is decreased as a result of mistakes or managers who put their own preferences above the well being of the firm as column 2 indicates, gains to targets are always positive. The acquired firm is usually paid a premium for the acquisition, so there are plus signs under each type of takeover theory. Then, we consider gains to acquirer as shown in column 3. In the first category of synergy, total value can be increased sufficiently to provide gains to acquirers under the hubris postulation; total value is not increased, so acquirers lose. With mistakes or agency problems, total value is decreased so that the gains to targets imply severe loses in value for acquirers.

Types of Takeover Strategies

Corporate takeovers may be classified under three broad classes:

1. ***Friendly Takeover:*** Friendly takeover happens with the consent of Target Company. In friendly takeover, there is an agreement between the management of two companies through negotiations and the takeover *bid* may be with the consent of majority of all shareholders of the target company. This kind of takeover is done through negotiations between two groups. Therefore, it is also known as negotiated takeover.

2. ***Hostile Takeover:*** When an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues efforts to gain control against the wishes of existing management, such acts of acquirer are known as 'hostile takeover'. Such takeovers are hostile on the management and are thus called hostile takeovers.

BOX 6.1 : HOSTILE TAKEOVER : MECHANISM
Tender offer and proxy fight are the two primary methods of conducting a hostile takeover. A tender **offer** is a public bid for a large chunk of the target stock at a fixed price which is higher than the current market value of the stock. The offer has a time limit and it may have other provision that the target company must abide to if shareholders accept the offer. The bidding company must disclose their plans for the target company and file relevant document as required under SEBI Takeover regulations. In a **proxy fight**, the buyer does not attempt to buy shares of the target company. Instead, they try to convince the shareholders to vote out current management/board in favour of a team that will approve the takeover. Proxy refers to the shareholders' ability to let someone else make their note for them, that is the buyer notes for the new board by proxy.
BOX 6.2: SWARAJ PAUL'S HOSTILE BID FOR ESCORTS AND DCM
In 1980s, London-based NRI Swaraj Paul made a hostile bid to control the management of two Indian companies, Escorts Limited and DCM (Delhi Cloth Mills) Limited by picking up their shares from the stock market. This had created lot of ripples in the Indian corporate sector and widely reported in the media. But he had to face major obstacles from government-run financial institutions. The Life Insurance Corporation opposed this hostile bid and supported the two distressed companies. The two companies refused to register the transfer of shares in his name. Promoters of the two companies - the Nanda and Shri Ram families - also used their political links to defeat the hostile bid of Paul. Though Swaraj Paul failed to fulfil his dream of controlling Escorts and DCM, but was successful in highlighting how particular families were able to exercise managerial control over large corporate entities despite holding a minuscule proportion of the concerned company's shares

3. ***Bailout Takeover:*** Takeover of a financially sick company by a profit earning company to bail out the former from liquidation is known as bail out takeover. There are several advantages for a profit making company to take over a sick company. The price would be very attractive as creditors, mostly banks and financial institutions having a charge on the industrial assets, would like to recover to the extent possible. Banks and other lending financial institutions would evaluate various options and if there is no other way except to sell the property, they will invite bids. Such a sale could take place in the form by transfer of shares. While identifying a party (acquirer), lender do evaluate the overall financial position of the acquirer.

Thus, a bail out takeover takes place with the approval of the financial institutions and banks.

Companies Act Provisions

The law relating to takeovers is contained in both the Companies Act, 2013 and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SEBI Takeover Code).

The Companies Act, 2013 deals with the power of a company to acquire shares of another company, generally (section 186), and specifically, in relation to acquiring from persons who did not sell or have not agreed to sell shares held by them, notwithstanding approval of the scheme or contract for acquisition of the shares by shareholders owning 90% and over of the shares (sections 235 and 236). The company being acquired could be either a public quoted company or a private limited company.

TAKEOVER OF LISTED COMPANIES

Takeover of companies whose securities are listed on one or more recognized stock exchanges in India is regulated by the provisions of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. However, if the acquisition of an unlisted company leads to indirect change in the control of a listed company, the transactions would be covered by the Regulations. Further, the Takeover Regulations are triggered if an acquirer company acquires the foreign parent company of a listed company.

BOX 6.3: SECTION 235 OF THE COMPANIES ACT, 2013 & TAKEOVERS

This section is not frequently used in practice and hence one often forgets its unique provisions. A recent decision of the Delhi High Court helps one not only understand the rationale of this provision but also is educative on when it can be used and when the court will not permit its use [in the case of *AIG (Mauritius) LLC* v. *Tata Televentures (Holdings) Ltd.* (2003) 43 SCL 22 (Del.)].

The facts of the Case: A company C engaged in the cellular telephony business had two groups of shareholders - the T group holding about 92 per cent and the A group holding the rest. The T group formed a new company in which it held 99.99 per cent (company "O"). Thereafter, company O made an offer to buy out the shares of the company C. It relied on the provisions of section 235. Thus, it was stated in the offer that if offers were received for shares constituting 90 per cent or more of the capital of C, then the remaining shares would be acquired at the same price. There was another related issue of giving proper notice as required by section 235 which was also given due importance but there was an important substantive question. Can the provisions of section 235 apply in such a case? Essentially, the scheme can be summarised as follows. There can be an offer to takeover a company which offer would be addressed to its shareholders. It may so happen that 90 per cent or more of the shareholders have agreed to the offer but the rest of the shareholders do not agree to it. In such a case, of course, the offeror can acquire the 90 per cent plus shares offered and live with the remaining shareholders. However, what if he does not wish the remaining shareholders to continue? On the other hand, what if the offeror has offered to acquire only from a group holding 90 per cent or more shares and not offered to the remaining shareholders and in such a situation these 10 per cent or less shareholders want the offer to buy their shares also? It is provided under section 235 that if the offeror wishes, he can compulsorily acquire the shares of the remaining shareholders on the same terms. In the other situation, the remaining shareholders can also require the offeror to acquire their shares. Now, in the first situation, the provision would appear to be drastic and involving expropriation. Also, it may be capable of misuse in the sense that it could be used to eliminate certain minority shareholders by acquiring their shares at a nominal value.

Acquisitions under section 235 did sound as acts of expropriation but there was a certain logic to it. If 90 per cent of the shareholders were in favour of a scheme, it would not be fair if the remaining small group held back its approval thus blocking it. The motives may be *mala fide*. As the Court observed, "In my opinion, it is not legally odious to expect to fall in line with the dictates of the overwhelming majority comprising ninety per cent of the group. Usually, there is wisdom in the strength of numbers. There is every possibility that where nine persons are willing to accept a particular offer, the remaining single person may be standing apart from the others for motives which are not mercantile or commercial". However, it was very important that for such an act to be allowed, it was a fair and *bona fide* one. The Court very importantly held that the same group that was in the majority could not use to remove the small majority under this provision. It was very essential that an independent person or group should be the offeror which was not so in the present case. In fact, the court held that "it was this very reason the section is deemed to be constitutional and if this was deviated from, it would amount to violation of fundamental rights and thus be struck down". The Court rejected the proposal.

Therefore, before planning a takeover of a listed company, any acquirer should understand the compliance requirements under the SEBI regulations and also the requirements under the listing Agreement and the Companies Act. There could also be some compliance requirements under the Foreign Exchange Management Act if an acquirer was a person resident outside India.

Takeover Bids

"Takeover bid" is an offer to the shareholders of a company, whose shares are not closely held, to buy their shares in the company at the offered price within the stipulated period of time. It is addressed to the shareholders with a view to acquiring sufficient number of shares to give the offerer company, voting control of the target company. A takeover bid is a technique, which is adopted by a company for taking over control of the management and affairs of another company by acquiring its controlling shares.

Types of Takeover Bids

Takeover bids may be a (*i*) mandatory (*ii*) voluntary (*iii*) competitive (*iv*) conditional.

Mandatory Bid

When an acquirer has agreed to acquire or acquired control over a target company or shares or voting rights in a target company which would be in excess of the threshold limits, then the acquirer is required to make an open offer to shareholders of the target company. Under SEBI New Takeover Code, 2011, Regulation 3(1), no acquirer shall acquire shares or voting rights in a target company which taken together with shares or voting rights, if any, held by him and by persons acting in concert with him in such target company, entitle them to exercise twenty-five per cent or more of the voting rights in such target company unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations.