CHAPTER 7

INSTITUTIONAL FACTORS BEHIND MERGERS AND TAKEOVERS IN INDIA IN THE POST-LIBERALIZATION REGIME

7.1 Introduction

With liberalization and the resultant changes in the Indian legal and institutional system, there were marked changes in industry climate that acted as a spur for merger and TO activities in the Indian corporate sector by both the MNCs and the domestic firms. Mergers and TOs in India prompted by the changes in economic environment triggered by liberalization policies, have partly been discussed in Chapter 5 (the effect of changes in governmental policies regarding stock markets on mergers and TOs) and Chapter 6 (effect of policy changes in foreign investment and international trade on mergers and TOs). The objective of this chapter is to investigate the intricacies behind the other institutional factors motivating TOs and mergers in India as a part of corporate restructuring in the period following economic reforms. Section 7.2 discusses the policy-induced causes behind mergers and acquisitions in India in the post-liberalization regime that have not been taken care of in Chapters 5 and 6. Section 7.3 concludes the chapter and briefly sets out the agenda for the chapter that follows.

7.2 Policy-induced Factors behind Mergers and Acquisitions in India

The liberalization exercises in 1991 involved policy changes, such as the dismantling of licenses and controls from a whole range of industries, repealing of certain relevant sections of MRTP, privatisation of hitherto public sector companies, reconsidering the treatment of sick industries and the rewriting of the Companies Act, 1961. These policy changes have been specially conducive to merger and TO activities in India. The NIP of 1991 abolished the need for prior approval of the government for mergers and acquisitions. For instance, the abolition of the Office of the Controller of Capital Issues (CCI) in 1992, the repealing of Chapter III (Section 23) of the MRTP Act, the dilution of FERA or the more recent scrapping of Section 22-A of the Securities Contract Regulation Act (SCRA) [1], directly represented a removal on the monitoring of the volume of merger and acquisition activities. The general objective behind these measures of liberalization was basically to remove internal entry barriers to domestic (and foreign) firms so as to bring about significant competition among them. TOs are now directly aided by the Securities and Exchange Board of India (Sebi) Regulations on Substantial Acquisition of Shares and TOs announced in November 1994, which has been subsequently being modified by Bhagwati Committee in 1997 [2], with a view to handling the intricacies of the market for corporate control, such as counter-bids, conditional bids etc.
In the subsections that follow, we will take up each of the institutional changes (those, that we have not discussed in the previous two chapters) and attempt to trace out how each of these changes affected the pattern of mergers and TOs in the country.

7.2.1 NIP and Industrial Licensing

*Industrial Licensing Policy before 1991*

The first major component of the regulatory framework prevailing in India till the 1990s was the system of industrial licensing for private industries, introduced by the Industries Development and Regulation (IDR) Act 1951. By “industrial licensing” we mean the licensing of capacity creation in a planned manner. The IDR Act, 1951, laid the foundations for administrative controls on industrial capacity through the licensing procedure. It enabled the government to direct industrial investments through a licensing system. Private enterprises producing basic and intermediate goods and large firms producing certain consumer goods were subject to industrial licensing. The elaborate licensing procedure was meant to direct industrialisation along desired direction (Goyal et al (1983)).

The first schedule of IDR Act gave an exhaustive list of all the industrial activities that needed licensing. The ambit of this Act extended to a comprehensive set of about 38 “scheduled” industries [3] which included defense industries, capital goods, metals, fuels, telecommunications, transport, fertilisers, chemicals, cement, timber, rubber, glass, ceramics, beside a host of consumer goods like textiles, drugs, paper, sugar, food and leather products. Within these industries, an industrial licence was needed by companies, for:

* setting up a new (large-scale) industrial unit,
* expanding capacity by more than 25% of existing levels,
* manufacturing a new product in an existing undertaking,
* producing anything which was subsequently brought under licencing
* changing location,
* companies that fell under the MRTP Act,
* companies with foreign equity that put them under FERA,
* importing capital goods,
* foreign collaborations, consisting of foreign investment, import of technology and design, and hiring of foreign technicians.

The major objectives of the policy of industrial licensing were:

* to create capacities in tune with plan targets -- in operational terms this meant that the government set the targeted output for each of the various industrial sectors and this output was apportioned among a large number of potential entrepreneurs. This was done to avoid over-investment in any activity.
* to prevent concentration of economic power by broad-basing the pattern of ownership.
to ensure balanced regional development in industrial capabilities — licensing was essentially used to disperse the industries across various regions/states so that there was no excessive concentration of it in any specific region or state.

The cases would then be reviewed on the basis of the suitability of the proposed enterprise or expansion plans, from the point of view of national objectives such as balanced regional development, prevention of concentration of economic power or excess capacities, encouragement of labour-intensive technology or small-scale industry and the need for scarce inputs or foreign exchange. The criteria used to judge the worthiness of an application were location, degree of capital intensity of the investment, and the effects on the overall scale of production. For those units seeking to import capital goods, a separate license was required. However, small units (less than 50 or 100 workers employed, depending on the use of power or with less than Rs. 25 lakhs worth of fixed assets) were exempt from the need to require a licence. So were industries seeking to augment their capacities by less than 25% of existing levels, and not requiring additional foreign exchange or scarce raw materials (Mookherjee (1995: 3-4)).

In spite of all the “national objectives” behind the implementation of industrial licensing, it was feared to bring about a policy-induced barrier to entry for new firms (because of costly delays in the process and resulting inefficiencies and wastages) in a number of industries. Industrial licensing also bore the possibility of sometimes being used strategically by established business houses to preempt capacity or reject the applications of new entrants. Moreover, it was also considered to restrict the firm size and also the growth of large firms by regulating expansion.

Accordingly, the experiments with liberalization of industrial controls had already begun in the mid-1970s, with relaxations in licensing system of engineering industries under the IDR Act. The delicensing of capacity creation had come in a phased manner since 1970s through 1985 in piecemeal moves [4]. After 1986, industrial licencing was no longer required for firms with assets below Rs. 5 crores (revised to Rs. 15 crores in 1988) and located at least beyond 30 miles from urban areas, as well as in 25 broad industry groups. Modernisation of equipment resulting in an increase of upto 49% of licensed capacity also no longer required additional licence.

Post-NIP Industrial Licencing Policy
In 1991, the preceding piecemeal moves towards delicensing were consolidated in a comprehensive policy statement. The NIP 1991, envisaged that some 8 industries (instead of 17 industries, earlier) would be reserved exclusively for public sector [5]. The new policy has removed even core industries such as iron and steel, electricity, air transport, ship-building and heavy machinery from the reserved list. Some 18 industries would require licensing [6]. Excluding this, no industry would require license, provided certain conditions were fulfilled [7]. The basic features of the delicensing policy of 1991 were:

(i) Industrial licensing was abolished for all industries (including MRTP/FERA companies and small scale and ancillary industries) except for a short list of
18 industries related to security and strategic concerns, social reasons, hazardous chemicals and overriding environmental reasons and items of elitist consumption that have a high proportion of imported inputs. Industries reserved for the small scale sector continued to be so reserved [8].

(ii) Areas where security and strategic concerns predominate will continue to be reserved for the public sector.

(iii) In projects where imported capital goods are required, automatic clearance would be given

(a) in cases where foreign exchange availability is ensured through foreign equity; or,

(b) if the CIF value of imported capital goods required is less than 25% of total value (net of taxes) of plant and equipment, upto a maximum value of Rs. 2 crore.

In other cases, imports of capital goods would require clearance from the Secretariat of Industrial Approvals (SIA) in the Department of Industrial Development according to availability of foreign exchange resources.

(iv) In locations other than cities with population of more than 1 million, there would be no requirement of obtaining industrial approvals from the Central Government except for industries subject to compulsory licensing. In respect of cities with population greater than 1 million, industries other than those of a non-polluting nature such as electronics, computer software and printing would be located outside 25 kilometres of the periphery, except in prior designed industrial areas.

(v) Existing units will be provided with a broadbanding facility to enable them to produce any article without additional investment.

(vi) The exemption from licensing capacity would apply to all substantial expansions of existing units.

(vii) The mandatory convertibility clause would no longer be applicable for new term loans from the Financial Institutions (FIs).

(viii) The existing registration schemes (Delicensed Registration, Exempted Industries Registration, DGTD Registration) stood abolished. Entrepreneurs needed only to file an information memorandum with the government, on the new projects and the expansions.

The industrial delicensing initiated in 1991 has been continued even in 1998. Coal and lignite, petroleum (other than crude) and its distillation products, bulk drugs and
sugar were delicensed. At present only five items of health, strategic and security considerations remain under purview of industrial licensing.

7.2.2 NIP and the MRTP Act

*Competition Policy and Antitrust/Antimonopoly Legislation*

Competition policy encompasses measures designated either to promote a more competitive environment or to prevent a reduction in competition. More generally, competition policies are expected to try to prevent firms undertaking practices, which adversely affect competition (Ferguson and Ferguson (1994: 162-163) by fostering concentration and encouraging anti-competitive and misleading trade practices. It is expected that competition policy should seek to break up or to regulate existing monopolies. It should also control firms' attempts to acquire such positions by merger.

Concentration of economic power can be viewed from two perspectives -- the macro level and the micro level (Sandesara (1994: 2083)). At the former level, the extent of concentration can be measured in terms of the extent of the share of a certain specified number of large (generally private) companies/business houses in the total corporate sector or the national economy. The share is measured on the criterion of assets, sales, employees, etc. The larger the share of that number the greater the concentration. High macro level concentration may attract concern, principally on the ground that it may produce adverse social and political consequences.

Concentration at the micro level relates to the share of a certain specified number of large private companies/business houses in the total sales/production in the industry/market in which the companies operate. The larger the share of that number, greater the concentration in the industry/market. The concern for high concentration of this kind germinates from the fear associated with monopolistic/oligopolistic markets, which it creates. Firms in such markets are said to suffer from various kinds of static and dynamic inefficiencies -- allocative, X and technological. And that is a common obstacle to the smooth functioning of the market.

Apart from concentration, there is the practice of adoption of other anti-competitive measures by firms such as monopolistic and restrictive trade practices, or misleading practices such as unfair trade practices, e.g., limiting technical development, collective price fixation, tie up sales, exclusive dealings, misleading advertisements, etc (Sandesara (1994: 2083)). Such unfair practices may result in the outcome being prejudicial to public interest or producing common detriment. Anti competitive or monopolistic practices are activities taken by an individual firm, which restrict, distort or prevent competition, generally through the erection of entry barriers. Restrictive practices are agreements between firms that have the effect of reducing competition. These practices have prompted different countries to have their own anti-trust regulations to control citations of concentrations and anti-competitive and misleading trade practices, though there are significant differences in the anti-monopoly legislations of the different countries.
The MRTP Act of India and Antitrust/Antimonopoly laws of UK, USA and Japan

In view of this, the MRTP Act was legislated in India in 1969 with a view to controlling concentration. At the macro level concentration was to be controlled in terms of the avoidance and prevention of concentration of economic power that may be prejudicial to public interest. At the micro level, it meant controlling the growth of monopolies as well as any trade practice which has, or may have, the effect of preventing, distorting or restricting competition in any manner (Section 2(0) of the MRTP Act; Chandra (1977: 1405-1418); Paranjape (1986)).

In India, till mid-1991, the MRTP Act was the main legislation for the control of monopolistic practices and concentration of economic power. The basic motivation came from a belief that monopoly is generally inefficient for corporate growth in the long-run and that there is always a need for fair distribution of income and wealth and prevention of concentration of economic power (for the background that led to the enactment of the MRTP legislation in 1969, refer to Sandesara (1994: 2081-84); Government of India (1963, 1964, 1965, 1969); Hazari (1967)).

The motivation of the MRTP Act was similar to that of the competition policy legislations in UK and antitrust policy in USA (Hay and Morris (1991: 612-622)). In UK, the competition policy is defined by four pieces of legislation: the Fair Trading Act, 1973, the Competition Act 1980, the Restrictive Trade Practices Act 1976 and the Resale Prices Act, 1976 (Merkin and Williams (1985); Shaw and Simpson (1986: 355-372); Kay and Mayer (1986: 199-209)). Shy (1997: 5) defines antitrust law as the legal structure governing the monitoring of the industry. However, the antitrust laws usually refer to laws governing the industry in terms of achieving competition and the restraints of monopoly power. With its Sherman Act (1890), Clayton Act (1914), Robinson-Patman Act (1936) and many more, the US has some of the most sophisticated legislation for deterring monopoly and encouraging competition (Asch (1983); Fisher (1987: 23-40); Gellhorn (1986); Salop (1987: 3-12); White (1987: 13-22)).

In Japan too, there is the Antimonopoly Law that restricts shareholding by a bank (or any other non-insurance financial institution) to a maximum of 5% of the company share. The effect of this restriction is made to prevent the re-emergence of a Zaibatsu-type giant trust with financial institutions at its centre. Hence the average shareholdings of the banks in the corporate sector (which was 17% in 1985) must be in the hands of several banks, rather than being concentrated in one or two. This pattern of share-ownership by several banks must imply that the controlling power of each bank is limited and that probably none of them has any real control. It is true that by collusion, the major banks would be able to acquire decisive controlling power. However, such collusion is prohibited under Antimonopoly law and is also extremely unlikely in view of the keen competition among banks (Odagiri (1994: 36-37)).
The MRTP Act prior to 1991

The Indian antitrust legislation, as embodied in MRTP 1969, distinguished between monopolistic and restrictive trade practices. The objectives of the MRTP Act thus were:

* to ensure that the functioning of the economic system does not result in the concentration of economic power
* to control such monopolistic and restrictive trade practices as are injurious to public welfare.

MRTP did not apply to government undertakings, which signalled that state monopolies were not considered harmful to public interest. Only “large business houses” and “dominant undertakings” came under the purview of MRTP Act. Chapter III of the MRTP Act defined these two categories of companies, which were known as MRTP companies. These were:

(i) large industrial houses

(a) undertakings which alone or together with not more than two other independent undertakings, held assets whose total value was not less than Rs. 20 crores (later raised to Rs. 100 crores in 1986) [9], and

(b) operated in one or more lines of business (large business houses)

(ii) dominant undertaking

(a) whose value of assets including those of interconnected undertakings [10] constituting the dominant undertaking, was not less than Rs. 1 crore, and

(b) which, either on its own or along with interconnected undertakings supplied or distributed or otherwise controlled at least one-third (later one-fourth) of the total industry output, of any goods or services within India as a whole or a substantial part thereof. One-third of the voting power or the right to appoint one-third of the directors was deemed to be sufficient for the purpose of control.

There were essentially two types of undertakings that came under the category of dominant undertaking. While the criterion for defining the former was based on assets held by a single large undertaking alone or together with its interconnected ones, the latter one was based on an asset-cum-market share of an enterprise alone or together with its interconnected ones. The second dominance criterion in MRTP legislation meant that it was easier for firms to diversify rather than expand in the same product line.

The notion of dominance via market share was bolstered by an asset classification of monopoly power: a company could be under MRTP if its assets were Rs. 100 crores or more; for a dominant company, the Act applied to assets exceeding Rs. 1 crore.
Any company meeting such a requirement needed to go through additional steps to obtain an industrial licence, if it was granted at all.

Chapter III of the MRTP Act regulated the expansion of large industrial houses and dominant undertakings. Under the MRTP Act, the large business houses and the dominant undertakings had to register themselves with the government within a short time. They had also to seek the government’s permission for substantial expansion, i.e., the rise in production or assets by 25% or more (Section 21(2) of MRTP Act), for starting a new undertaking (Section 22). Mergers and amalgamations that resulted in generating large industrial houses or dominant undertakings would also require clearance from the MRTP Commission, under Section 23 and Section 24 of the MRTP Act. The government held the power to order an undertaking to divest part of its assets or to break it up into independent undertakings. The government might seek MRTP Commission’s advice but the advice was not binding.

The MRTP Act thus, by Chapter III, had imposed restriction on the growth of firm size and also restricted the growth of small firms. The growth of large business houses and concentration of economic power was sought to be controlled by the MRTP Act, which required large or inter-connected firms to seek prior approval before investment, and that too in a selected list of "core" industries in which they were allowed to invest.

The MRTP Act has been amended several times since 1969, in 1980, 1982, 1984, 1985, 1986, 1998 and 1991 [11]. Besides, from time to time, rules have been framed to carry out the objectives of the Act. Of the amendments referred to, those of 1984 and 1991 are comprehensive and far reaching relatively to others, as they were based, respectively on the recommendations of the Rajinder Sacher Committee made in 1978 (Government of India (1978)) and on the NIP in 1991.

Post-NIP MRTP Act
The MRTP Act has gone through significant amendments by the ordinance of 1991 with respect to the removal of the threshold limits of assets in respect of MRTP companies and dominant undertakings. On the whole, the rigour of the MRTP Act became considerably reduced, making it virtually irrelevant as far as the expansion of monopoly houses was concerned. The provision under the MRTP Act, imposing restrictions on investment and production on firms of groups with assets above Rs. one billion was abolished.

The industrial policy reforms of 1991 and the resultant amendment of MRTP Act deleted the concept of an MRTP company, and repealed as a follow up, almost all provisions relating to their expansion. The entire Chapter III of the MRTP Act restricting the growth in size of firms or mergers of large business houses was eliminated. This abolished the requirement by firms of prior approval of the central government for expansion of their existing capacity (section 21 of the Act), establishment of new undertaking (section 22), mergers, amalgamation and TO of other undertakings (section 23) (except when the industrial unit is operating in some core sector), and for the appointment of certain directors. The provisions regarding restrictions on acquisition and transfer of shares were proposed to be incorporated in
the Companies Act. On the other hand, emphasis was now placed on controlling and regulating monopolistic, restrictive and unfair trade practices. If there is any complaint that the merger or TO activity is being monopolistic or restrictive to free competition or will lead to unfair trade practices, MRTP Commission will investigate the case and either the government or the MRTP Commission has the power to intervene. The amended Act also withdrew generally the exemption of the public sector from the provisions of the Act. In brief, the amendments have enlarged the scope of the Act by bringing into its fold of control unfair trade practices and reduced its scope by removing from control the situations of aggregate concentration.

To sum up, the restrictions imposed by the MRTP Act, 1969 were of two kinds: pre-entry and post-entry. With the scrapping of the asset limits the pre-entry restrictions were no longer required. So all provisions relating to expansion, setting up of new undertakings, mergers and amalgamations and TOs were to be removed. The government also decided to transfer into the Companies Act, all rules relating to the restrictions on acquisition and transfer of shares. The scrapping of the asset limit for MRTP registered companies envisaged in the industrial policy, 1991, enabled more than 1800 companies (Tandon and Tandon (1997: 397) to do away with the requirements of prior approval of the Central Government for establishing new undertakings, expansions, mergers, amalgamations and TOs and appointment of directors.

However, the post-entry restrictions were being tightened to ensure that concentration of economic power did not affect the common man. The newly-empowered MRTP Commission was now encouraged to take \textit{suo moto} action on allegations of unfair or restrictive business practices. It is said that after 1991, with the deletion of MRTP companies, the MRTP Act has virtually become an RTP Act. There are three distinct words in the phrase RTP, which we will define (Section 2-(s) and section 2-(u) of the MRTP Act). Trade is defined widely to include besides trade, business, industry, profession or occupation, and relates to production, supply, distribution or control of goods, and includes the provision of services. Trade practice is any practice relating to the carrying of trade. Central to the definition of RTP is the concept of restriction on competition by trade practice.

With regard to merger and acquisition activities in India in the liberalized regime, the post-entry restrictions in the MRTP Act are as follows. If there is any outside complaint that any TO or merger activity is monopolistic or restrictive to free competition or will lead to unfair trade practices, the MRTP Commission will investigate the case and either the government or the MRTP Commission has the power to intervene.

\textit{Effect of Delicensing and Removal of MRTP Restrictions on Mergers and TOs in India in the 1990s}

Anant and Goswami (1998: 241-242) have pointed out that the combined effect of market share, asset classification, industrial licensing and product reservation for the public sector prevented private sector companies from attaining globally competitive scales of production. Many business groups had acquired a large number of businesses under the old industrial policy, without much regard to specific capabilities or strengths to compete in the business. Consequently, by the 1990s, there
were many companies with fragmented capacities and high costs. Furthermore, there was entry deterrence through capacity preemption. The restrictions on the size of industrial units had resulted in plant sizes that were out of line with the global trends in minimum scale economies (Khanna (1999: 3236)). Also, since MRTP prevented growth in existing areas, it forced large corporations to diversify into activities in which they had little expertise and marginal comparative advantage. For example, such diversification into unrelated activities was made by Tisco in the seventies. Tisco had set up a substantial number of companies that were outside its core competence, namely production and distribution of steel. Only after MRTP revoked its definition of dominance and asset classification, Tisco decided to divest itself of most of these non-synergic units and concentrate on steel manufacturing instead.

Similarly, Escorts Tractors Limited, a joint venture collaboration between Escorts Limited and Ford New Holland decided to merge with itself in 1995, Escorts Limited, the flagship company of the Rajan Nanda group. It was a case of horizontal merger. This merger was entered into in the process of corporate restructuring whereby the Nandas wanted to concentrate on their core activity of manufacturing tractors. The Nandas had diversified in various lines of production and they had already got rid of their motor cycle, construction and telecom businesses before they entered into this in-group merger [12].

As we have already seen above, the industrial policy reform of 1991 and thereafter have removed barriers for entry for new firms and limits on growth in size for existing firms. Theoretically, the delicensing was envisaged to reduce the heights of entry barriers in the Indian manufacturing sector. Industrial licencing has been abolished for all industries those specified, irrespective of levels of investment and the exceptions are few. Investment decisions are thus no longer dependent on government approval or constrained by State intervention. With the removal of this policy-induced capacity barrier under the NIP, it implied that output could now be produced in line with demand in the majority of the industries. And a natural follow up would seem to be a greater entry of firms in these industries, a rise in output, a greater play of market forces and a consequential fall of costs and prices.

However, in this connection, we must recall that there is another policy-induced capital barrier to entry, which has in a sense contradicted the prospective effect of delicensing on entry conditions. This is the policy of “Minimum Economic Scale” (MES) of output in about 72 industries, fixed by the government in 1985-86, with a view to encouraging realisation of economies of scale by expansion of the existing installed capacities to minimum economic scale of operations. In the licensing regime this meant that any future capacity creation in those specific industries would have to conform to MES predetermined by the government.

As a matter of policy, this MES facility was also extended to MRTP companies. The MES of output, fixed at a unique level for all the industries, valid since 1986, acted as an entry-barrier to new firms in the delicensed industries. This was because, at such pre-determined capacities, the cost of setting up/creating plants was so high that only a few entrepreneurs could enter that too with the help of public financial institutions. Thus, even after delicensing entry had not smoothened; the MES acted as a policy-
induced capital barrier to entry. It was easier for existing units to expand to such capacities than a fresh unit to come up [13]. Therefore, the only alternative by which the corporate sector could take advantage of delicensing was by the expansion of existing firms — an expansion, which they could not resort to in the MRTP days.

As already mentioned, expansion can take two routes — internal and external (mergers, acquisitions, TOs, etc). There are various economic limitations of internal expansion. Moreover, with the removal of MRTP restrictions on plant size and the abolition of the need for prior government approval for mergers, amalgamations and TOs, which was under section 23 of MRTP Act (currently abolished), the existing large firms could now merge their plants to reduce overheads, cut costs, increase profit margins and also in the process, reduce the number of firms in the industry and thus increase concentration. Thus, given the policy changes of delicensing and MRTP deregulation, mergers and acquisitions seemed to be a profitable route to follow for the domestic firms in the path of corporate restructuring.

The abolition of the licensing system and removal of MRTP stipulations have thus led, among other things, to mergers amongst a business group itself or even acquisitions of other companies within the same industry. Many of the large acquisitions in the post-liberalization regime took place because of the dismantling of these policies of the government. It may be mentioned that it is in this process of corporate restructuring that the Tata group sold out Tomco, Ajay Piramal acquired Roche Products (later renamed Piramal Healthcare) and so on, so as to consolidate business. For the acquirers, procuring instant capacity was a strong motivating factor. Also, mergers were witnessed in certain production sectors India like cement, chemicals, synthetic fibres, white goods and textiles so as to enhance their scale of operations through new investment and new induction of technology (Appendix 3.1). Indian firms have also been trying to widen their range and scope of products through acquisitions or buying or selling of brands, so as to compete with the MNCs. Thus Ranbaxy that earlier concentrated on the anti-infectious drugs group has tried to acquire other product lines and brands to achieve synergies in its marketing, distribution and R&D operations (Khanna (1999: 3237)).

7.2.3 Public Sector Reforms

The concept and forms of "public sector"
The term "public sector" itself is an omnibus category covering a wide gamut of activities: mining, manufacturing, public utilities, trade, transport, banking, finance and services. The public sector in India enjoys a monopoly status in railways, coal, non-ferrous metals (other than aluminium), near monopoly positions in electricity, postal services, airlines, and petroleum and to some extent in telecommunications; dominant positions in steel, heavy machinery and bus transport; and competes with private firms in fertilisers and chemicals, drugs and pharmaceuticals and many consumer goods industries. Utility services such as electricity and telecommunications are non-tradable and non-storable. Among the production of some of the commodities now produced under the auspices of public sector in India, several were originally under the private sector and later nationalised by the
government. For example, railways were nationalised in the British rule. Some, such as banks, insurance companies, coal mines, etc. were nationalised after Independence. In some other cases, the state started enterprises on its own: the examples of atomic power, sophisticated machine tools, heavy engineering, railway locomotives, etc. In fact, there are industries in India where both public and private enterprises operate, producing very similar goods. Bagchi (1994: 392) attributes this phenomenon to the structure of public sector that has evolved as a result of many ad hoc decisions taken at different moments of time. However, there are also ‘club goods’ (Cornes and Sandler (1986)) and pure public goods (goods with strong external effects on production and consumption) produced by our public sector.

The organisational forms for public enterprises are not the same. There are both departmental (run departmentally, like the Indian Railways, Posts and Telegraphs, telecommunications (except the Mahanagar Telephone Nigam Ltd., Bombay and Delhi, and the Videsh Sanchar Nigam Limited)) and non-departmental enterprises (enterprises that have been given a corporate form), under the control of the central, state and local governments. These non-departmental enterprises include public corporations and public limited companies. Such enterprises are registered under the Indian Companies Act, 1956. In a public limited company, the whole of capital stock or 51% or more of it is owned by the government. In general, public sector in India comprises the departmental enterprises as well as the autonomous corporations. This includes the enterprises run by the Central and state governments as well as local bodies.

Public Sector Units before NIP, 1991

The 1956 Industrial Policy Resolution stressed that the realisation of the objectives of growth with social justice, as envisaged by the philosophy of a “socialistic pattern of society”, required that all industries of basic and strategic importance, public utility services and all other industries which required investment on a scale which only the state could provide, must be in the public sector. It thus advocated for the sustained expansion of public sector. An instrument to ensure future public sector dominance was reservation. Accordingly, it defined three categories of industries. Schedule A included 17 key industries of “basic or strategic importance, or in the nature of public utilities” (including defense, capital goods, minerals, iron and steel, ship-building, rail and air transport, telecommunications and electricity) in which all future investments were exclusively reserved for the public sector. Existing private enterprises would be allowed to operate, excepting defense and transport which were to be public sector monopolies. Schedule B included 12 industries such as various intermediate goods (fertilisers, aluminium, machine tools, drugs, plastics, synthetic rubber, etc.), and road and sea transport, which were intended to be progressively state-owned, though private enterprises would also be allowed to expand. All remaining industries formed the third category, in which primary reliance was placed on the private sector, though it would be open to the state to start any industry even in this category. The resolution also emphasised the fruitful cooperation between the two sectors. Although the government took to nationalisation after Independence, it announced its intention in 1988 not to nationalise sick industries, to close down unviable public sector units, and to open up areas hitherto reserved for public sector.
There is no single index to measure the importance of the public sector, or its transformation over time. The importance can be measured in terms of various indicators such as the number of public sector units over time, employment, output, income generated, savings, capital formation, capital stock, consumer of different goods and services produced in the economy, etc. We will however resort to number of public sector units over time, employment, savings and capital formation in Table 7.1 to Table 7.4 to indicate the role of public sector in India in the pre-liberalization era. With respect to the number of public sector units the data that we have in hand refer to that of the central public sector enterprises. This can be taken as a proxy for the entire set of public sector units in the absence of comprehensive data. Wherever possible, we will show the position of the public sector vis-a-vis private sector in the Indian economy. We are aware that Table 7.1 to Table 7.4 give a very limited and partial picture of the importance of public sector in both static and dynamic terms and that there are several other dimensions of the role of public sector that can be taken care of for a comprehensive analysis. The set of forward and backward linkages of the public sector with the rest of the economy over an annual production cycle and the portrayal of changes in these linkages over time. Bagchi has elaborated on this dimension of public sector and has also discussed at great length about the complications in analysis arising out of a consideration of the linkage effects of public sector activities and their changes (Bagchi (1994: 393-403)).

**Number of Public Sector Enterprises and the Investment therein**

Table 7.1 provides a list of the number of central government enterprises over the plans till 1990. The table indicates that there was a phenomenal growth in this sector over a period of nearly 40 years. In 1951 there were only 5 such public sector enterprises, which increased to 244 i.e., 49 times in March 1990.

| Number of Central Government Enterprises in India over the Plans |
|-------------------------------|-----------------|
| **At the commencement of First Plan (1.4.51)** | 5 |
| **At the commencement of Second Plan (1.4.56)** | 21 |
| **At the commencement of Third Plan (1.4.61)** | 47 |
| **At the end of Third Plan (31.3.66)** | 73 |
| **At the commencement of Fourth Plan (1.4.69)** | 84 |
| **At the commencement of Fifth Plan (1.4.74)** | 122 |
| **At the end of Fith Plan (31.3.79)** | 169 |
| **At the commencement of Sixth Plan (1.4.80)** | 179 |
| **At the commencement of Seventh Plan (1.4.85)** | 215 |
| **As on 31.3.89** | 238 |
| **At the end of the Seventh Plan (31.3.90)** | 244 |

*Source: Government of India, Public Enterprise Survey (1995-96)*

Table 7.2 shows public versus private sector employment in India prior to 1991. The last column of the table shows that over the 20 years, 1971 to 1991 public sector employment to total employment in public plus private sector had been at a rising
trend. This infers that public sector was the major employment generating sector in India till 1991. The table also infers that employment creation in the organised sector has proceeded faster in public than in private sector.

**Table 7.2**

Public and Private Sector Employment in India over 1971 to 1991

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Sector (Lakhs)</th>
<th>Private Sector (Lakhs)</th>
<th>Total (Lakhs)</th>
<th>Public Sector as % of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>71.0</td>
<td>121.0</td>
<td>192.0</td>
<td>55.0</td>
</tr>
<tr>
<td>1976</td>
<td>133.2</td>
<td>68.4</td>
<td>201.6</td>
<td>66.1</td>
</tr>
<tr>
<td>1981</td>
<td>154.8</td>
<td>73.9</td>
<td>228.7</td>
<td>67.7</td>
</tr>
<tr>
<td>1986</td>
<td>176.8</td>
<td>73.7</td>
<td>250.5</td>
<td>70.6</td>
</tr>
<tr>
<td>1990</td>
<td>187.6</td>
<td>75.8</td>
<td>263.4</td>
<td>71.2</td>
</tr>
<tr>
<td>1991</td>
<td>190.6</td>
<td>76.8</td>
<td>267.4</td>
<td>71.3</td>
</tr>
</tbody>
</table>


**Share of Public Sector in Capital Formation**

Table 7.3 shows the contribution of public and private sectors to the gross domestic capital formation in the economy. Gross domestic capital formation for public and private sectors taken together as a percentage of GDP at current market prices has increased from 10.7% in the First Plan to 22.8% in the Seventh Plan to 25.2% in 1990-91. However, the share of the public sector improved from 3.5% in the First Plan to 10.7% in the Seventh Plan with intermittent rises and falls. The corresponding change for the private sector was a more or less consistent rise from 7.2% to 12.1% to 15.5% with marginal falls from the immediately preceding estimates in the Third and Sixth Plans. The share of public sector in total gross capital formation increased from 33% to 47% over 1951 to 1990 and then fell to 38.5% in 1990-91.

**Table 7.3**

Share of Public and Private Sectors in Gross Domestic Capital Formation in India over 1951-1991

<table>
<thead>
<tr>
<th>Averages for Gross Domestic Capital Formation over the Plan Periods</th>
<th>Public Sector as % of GDP at current market prices</th>
<th>Private Corporate Sector as % of GDP at current market prices</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>First Plan: 1951-56</td>
<td>3.5</td>
<td>7.2</td>
<td>10.7</td>
</tr>
<tr>
<td>Second Plan: 1956-61</td>
<td>6.6</td>
<td>8.8</td>
<td>15.4</td>
</tr>
<tr>
<td>Third Plan: 1961-66</td>
<td>8.4</td>
<td>8.3</td>
<td>16.7</td>
</tr>
<tr>
<td>Annual Plans: 1966-69</td>
<td>7.2</td>
<td>10.1</td>
<td>17.3</td>
</tr>
<tr>
<td>Fourth Plan: 1969-74</td>
<td>7.2</td>
<td>10.9</td>
<td>18.1</td>
</tr>
<tr>
<td>Fifth Plan: 1974-79</td>
<td>9.5</td>
<td>11.7</td>
<td>21.2</td>
</tr>
<tr>
<td>Sixth Plan: 1980-85</td>
<td>11.1</td>
<td>10.5</td>
<td>21.6</td>
</tr>
<tr>
<td>Seventh Plan: 1985-90</td>
<td>10.7</td>
<td>12.1</td>
<td>22.8</td>
</tr>
</tbody>
</table>

Share of Public Sector in Saving

The share of savings by the public sector has not witnessed a similar change. Table 7.4 shows that the share of public sector in gross domestic saving rose from 1.7% of GDP during the First Plan to 4.6% in the Fifth plan terminating in 1979. Thereafter it started falling, reaching 2.3% in the Seventh Plan. It again reduced to 1% in 1990-91. The share of public sector in total gross domestic savings reduced from 63% in the First Plan to 53.5% in 1990 and then fell to 26.3% in 1990-91.

Table 7.4

<table>
<thead>
<tr>
<th>Averages for Plan Periods</th>
<th>Public Sector as % of GDP at current market prices</th>
<th>Private Corporate Sector as % of GDP at current market prices</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Domestic Savings</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First Plan: 1951-56</td>
<td>1.7</td>
<td>1.0</td>
<td>2.7</td>
</tr>
<tr>
<td>Second Plan: 1956-61</td>
<td>2.0</td>
<td>1.2</td>
<td>3.2</td>
</tr>
<tr>
<td>Third Plan: 1961-66</td>
<td>3.4</td>
<td>1.7</td>
<td>5.1</td>
</tr>
<tr>
<td>Annual Plans: 1966-69</td>
<td>2.4</td>
<td>1.5</td>
<td>3.9</td>
</tr>
<tr>
<td>Fourth Plan: 1969-74</td>
<td>3.0</td>
<td>1.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Fifth Plan: 1974-79</td>
<td>4.6</td>
<td>1.5</td>
<td>6.1</td>
</tr>
<tr>
<td>Sixth Plan: 1980-85</td>
<td>3.6</td>
<td>1.6</td>
<td>5.2</td>
</tr>
<tr>
<td>Seventh Plan: 1985-90</td>
<td>2.3</td>
<td>2.0</td>
<td>4.3</td>
</tr>
<tr>
<td>1990-91</td>
<td>1.0</td>
<td>2.8</td>
<td>3.8</td>
</tr>
<tr>
<td>1991-92</td>
<td>1.9</td>
<td>3.2</td>
<td>5.1</td>
</tr>
<tr>
<td>1992-93</td>
<td>1.5</td>
<td>2.8</td>
<td>4.3</td>
</tr>
<tr>
<td>1993-94</td>
<td>0.5</td>
<td>3.4</td>
<td>3.9</td>
</tr>
<tr>
<td>1994-95</td>
<td>1.5</td>
<td>3.4</td>
<td>4.9</td>
</tr>
<tr>
<td>1995-96</td>
<td>1.9</td>
<td>4.8</td>
<td>6.7</td>
</tr>
<tr>
<td>1996-97*</td>
<td>1.5</td>
<td>4.1</td>
<td>5.6</td>
</tr>
<tr>
<td>1997-98**</td>
<td>1.0</td>
<td>3.8</td>
<td>4.8</td>
</tr>
</tbody>
</table>


* Provisional estimates.
** Quick Estimates.

Note: Ratios of capital formation of individual sectors may not add to totals because of rounding off.

Figures up to 1992-93 are based on old series (Base: 1980-81) and figures from 1993-94 onwards are based on new series (Base: 1993-94)
On the basis of Table 7.3 and Table 7.4 we may conclude that the contribution of public sector in both gross capital formation and gross saving have shown a downward tilt. The only difference visible from the tables was that while this downturn started for gross domestic savings in the Sixth Plan, it took five more years for the share of public sector in gross domestic capital formation to exhibit a fall. These figures indicate failure of the public sector enterprises to generate internal surplus commensurate with the increase in their capital stock.

However, in spite of greater capital intensity and larger scale of operations, the problem with the public sector units was that performance in terms of surplus generation and profitability had not been keeping with the vast growth in the size of the public sector enterprises. The number of loss-making public sector companies can be taken as one of the indices of fall in profitability of the public sector in India. In 1991-92, 102 out of 237 PSUs made losses. Table 7.5 enlists a number of sick public sector undertakings and indicates the amount of their losses, as they stood in 1991-92.

A loss-making company becomes a "sick company" as per Section 3(1) of Sick Industrial Companies (Special Provisions) Act (Sica) when it satisfies three conditions:

* it should be an industrial company
* it should be registered for at least 5 years — a company usually makes losses in the initial years and hence, initial losses does not mean that the industrial company is sick.
* at the end of the financial year, accumulated losses should be equal to or more than its entire net worth.

The inefficiency of the public sector has been documented and emphasised by many institutions and committees, such as the Arjun Sengupta Committee of 1986 [14] and the Chakravarty Committee of 1987 [15]. A study by Sankar, Tilak and Sai (1989) enquired into the profitability of 541 public and private limited companies whose balance sheets are analysed by the Reserve Bank of India and the profitability of the central government public enterprises whose balance sheets are analysed by the Bureau of Public Enterprises. The period of study was 1983-84 to 1985-86. The finding was that the privately owned firms realised a larger return on capital (measured as a ratio of profit before tax plus interest to total capital employed) than public enterprises, but the difference reduced considerably after the sick units were excluded.
Table 7.5
A sample of sick Public Sector Units in India in 1991-92

<table>
<thead>
<tr>
<th>Company</th>
<th>Losses (Rs. Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Engineering Projects Ltd.</td>
<td>64.99</td>
</tr>
<tr>
<td>HISCO</td>
<td>898.97</td>
</tr>
<tr>
<td>Hindustan Antibiotics</td>
<td>62.38</td>
</tr>
<tr>
<td>Bharat Coking and Coal</td>
<td>1293.03</td>
</tr>
<tr>
<td>Export Credit and Guarantee</td>
<td>86.04</td>
</tr>
<tr>
<td>Fertiliser Corporation</td>
<td>2484.33</td>
</tr>
<tr>
<td>HFC</td>
<td>2623.65</td>
</tr>
<tr>
<td>Projects and Development</td>
<td>122.97</td>
</tr>
<tr>
<td>Braithwaite &amp; Company</td>
<td>159.01</td>
</tr>
<tr>
<td>Burn Standard Company</td>
<td>292.03</td>
</tr>
<tr>
<td>Heavy Engineering Corporation</td>
<td>960.42</td>
</tr>
<tr>
<td>Instrumentation Ltd.</td>
<td>30.98</td>
</tr>
<tr>
<td>Jessop &amp; Company</td>
<td>208.43</td>
</tr>
<tr>
<td>Mining &amp; Allied Machinery</td>
<td>358.15</td>
</tr>
<tr>
<td>National Small Industries</td>
<td>102.22</td>
</tr>
<tr>
<td>Richardson &amp; Cruddas</td>
<td>108.36</td>
</tr>
<tr>
<td>Tyre Corporation</td>
<td>188.16</td>
</tr>
<tr>
<td>Bharat Gold Mines</td>
<td>205.58</td>
</tr>
<tr>
<td>Bharat Refractories</td>
<td>84.78</td>
</tr>
<tr>
<td>Hindustan Steel Works</td>
<td>629.82</td>
</tr>
<tr>
<td>Hindustan Shipyard</td>
<td>780.89</td>
</tr>
<tr>
<td>Jute Corporation</td>
<td>40.66</td>
</tr>
<tr>
<td>NTC (Gujarat)</td>
<td>449.06</td>
</tr>
<tr>
<td>NTC (MP)</td>
<td>408.72</td>
</tr>
<tr>
<td>NTC (Maharashtra North)</td>
<td>463.48</td>
</tr>
<tr>
<td>NTC (Maharashtra South)</td>
<td>411.05</td>
</tr>
<tr>
<td>NTC (UP)</td>
<td>488.01</td>
</tr>
</tbody>
</table>


Various standard reasons have been cited for the excess costs and the loss of profitability suffered by public sector units in India. Apart from the usual factors like the general state of the economy, inflationary pressure, demand for goods and services, prices, including administered prices, modernisation and renovation of plant and equipment, upgradation of technology, etc., that contribute to the success or failure of an enterprise, there are some costs associated with PSUs in terms of bureaucratic delays in taking a decision and/or its implementation so that the estimated cash-flow is affected and the project takes time to go on stream, lack of modernisation of existing PSUs, orientation of management and the like. However, it has been justified by Bagchi (1994: 393–403) in his article that many of these reasons are exaggerated and do not take into account many socio, political and economic factors.
Public Sector and the Post-1991 Reforms

From the middle of 1991, India adopted a regime of macroeconomic management, which closely followed the contours of structural adjustment policies as recommended by the IMF and World Bank. Public sector reforms constituted a part of that management package. Accordingly, the NIP 1991 seemed to contain the following objectives regarding the reforms of the public sector.

- To reduce the activities of the public sector: Public sector was desired to focus only on those sectors which are strategic or high technology or constitute an essential part of the high infrastructure. Public sector’s ambit was decided to be reduced from 17 to 8 industries and selective competition in the reserved area was to be introduced which has been further reduced to 6. These include defence products, atomic energy, coal and lignite, mineral oils, railway transport, minerals specified in the schedule to Atomic Energy Order 1953. Even in these areas, private sector participation would be allowed selectively. Thus, joint ventures with foreign companies in oil exploration and production now became possible. The private sector can enter practically all areas; though reservation of some areas for the public sector has been retained, there would be no bar for even these areas to be opened up to the private sector selectively.

- To ease the burden on the exchequer on account of the public sector: Disinvestment of government equity in the public sector units up to 20% (later raised to 49%) was to be done to raise resources and encourage wider participation of the public and workers in the ownership of public sector enterprises. Upto 49% of the Government’s shareholding in the public sector would be sold to FIs, mutual funds, employees and the general public with a view to imparting a commercial orientation to public sector enterprises. The objective was that the mutual funds etc. would seek a listing for the shares on the stock market and would have the freedom to dispose them off after a specified period.
To facilitate the closure of sick units in the public sector by extending the Board for Industrial and Financial Reconstruction's (BIFR) purview to the public sector. The government amended the Sica by February 1992 and armed itself with powers to tackle the sick or potentially sick public sector units. According to the provisions of the amended Sica, it became mandatory that all chronically sick public sector units would get referred to BIFR for rationalisation and rehabilitation suggestions. The BIFR would decide whether the referred units can be effectively reconstituted or whether they should be closed down. The Act would apply to all industries, which fall under the First Schedule to the IDR Act 1951 with the exception of the scheduled industry related to ships and other vessels drawn by power. In case a public sector unit is declared sick through an order the government could appoint an operating agency which will have to prepare a scheme within 90 days for the sick company providing various options such as amalgamation of the sick company with any other industrial company, lease of part or whole of the sick company, or outright sale of the sick company. The government notified four Central FIs and eight nationalised banks as operating agencies for this purpose. If the report of the operating agency revealed that it was not possible to revive a sick industrial company even by measures like amalgamation, reconstruction, sale of the whole or part of the company, the Bench of the BIFR may form the prima facie opinion that the company would be wound up. Show cause notice for winding up may be issued following the prescribed procedures including, if necessary, a reference to the High Court. Through this route, even the closure of public sector units became possible.

Mergers and TOs and Public Sector Enterprises in India

Merger, acquisition and TO activities come in the analysis of public sector reforms through the above mentioned objectives of privatisation, asset sales through divestment and closure. Broadly speaking, privatisation is the general process of involving the private sector in the ownership and/or operation of a state owned enterprise. Divestment or selling off of equity of the enterprise is an instrument of privatisation.

In spite of strong rhetoric in favour of privatisation and divestment, there has been stiff resistance by the officers and employees of many public enterprises in India of the pressure of closure or privatisation. For example, when the government decided to transfer the ownership of Scooters India, a loss making public sector unit to Bajaj Auto Ltd., the workers’ union intervened and claimed that this would go against the interests of labour. This prompted the government withdraw the proposal. In some cases, there has also been active planning by the employees for reconstruction of loss-making public enterprises. The example of Kamani Tubes – a loss-making private sector corporation shows that the workers’ cooperative experiment can lead to recovery, and a sick public sector enterprise can become a profit making enterprise under worker management.

Despite all resistance, the government has been able to transfer the ownership of some public sector units to private sector. Notable among these attempts at
privatisation are the handover of Ailwyn Nissan, a public sector unit of Andhra Pradesh to Mahindra and Mahindra Ltd., the TO of Mangalore Chemicals and Fertilisers by the UB group, the TO of Maharashtra Scooters by Bajaj Auto, etc. Not only the outright sale of companies, there has been a reshuffling in the equity stake of some public sector companies leading to virtual acquisition of the public sector unit, e.g., the hike in equity stake in Webel Telecommunication Industries by Philips. Also, there has been some BIFR induced mergers between public sector units. As our study is mainly concentrated on listed public limited companies, we do not have many cases of mergers and TOs between public companies. Yet this does not reduce the importance of the role of public sector reforms as a part of the liberalization strategy of the government as one of the forces operating behind the current mergers and TOs in India.

The opening up of several sectors earlier reserved for the public sector (like telecom, power, ports etc.) without any attempt at enhancing the autonomy and restructuring the public sector enterprises means that such enterprises face unequal competition, and despite considerable strengths, have been unable to respond. Absence of powerful Indian firms in these sectors has meant that several of these sectors are slowly targeted for TO by MNCs with little resistance from Indian firms.

Case Study
The acquisition of majority control of Webel Telecommunication Industries, a wholly owned West Bengal Government unit by Philips, a Dutch MNC in 1994 is one such example of TO of public sector unit in India by an MNC.

Philips - Webel Telecommunication Industries TO
In July 1994, the Dutch MNC, Philips was reported to have acquired 51% shares of Webel Telecommunication Industries against 49% of WB government. The pre-acquisition distribution of shares was 40% for Philips and 60% for Webel Telecommunications Ltd.

Acquired company - Webel Telecommunication Industries
Webel Telecommunication Industries mainly manufactured wireless telecommunication equipment widely used by the police, paramilitary forces and other government agencies. It had an annual turnover of more than Rs. 20 crores and was a profit making unit which, till 1994, had been paying around 20% dividend.

Reason for TO
Privatisation through divestment of equity was presumably the motive of the state government behind handing over the company to Philips. It is surmised that with large telecommunication companies like Motorola and Alcatel having made moves to enter the Indian market, the government opted for privatisation presumably because of the paucity of funds and the dearth of state-of-the-art technology to upgrade and widen the range of its products so as to compete with the potential entrants [16].
7.2.4 Mergers and TOs under the Rehabilitation Plan of the BIFR

Legal Provisions under BIFR

Tax saving under Section 72A of the Income Tax Act, 1961 by bailing a sick firm out of sickness is a frequently observed factor for mergers and TOs in our country. Section 72A of the Income Tax Act has provisions for carry-forward and set-off of accumulated loss and unabsorbed depreciation allowances in certain cases of amalgamation between a sick unit and a profitable one. It is attractive for amalgamation of a sick company with a healthy and profitable one to take advantage of these carry forward losses. The conditions are:

The amalgamating company is not financially viable by reasons of its liabilities, losses and other relevant factors immediately before such amalgamation.

Amalgamation is in public interest.

Any other conditions of the central government to ensure that the benefit under this section is restricted to amalgamations which enable rehabilitation or revival of the business of the amalgamating company.

The merger between sick and healthy companies so as to enjoy tax benefits under Section 72A of the Income Tax Act, 1961, has to be approved by the BIFR. A large number of mergers of sick companies with healthy ones has taken place in India in recent times under the merger-cum-rehabilitation plan sanctioned by BIFR between private sector companies, public sector companies as also between private and public sector firms. The BIFR came into existence in 1987, by notification of the central government to work out as well as review alternative schemes for rehabilitation/closing down of sick industrial units. BIFR is vested with the power to legally bring about a change in the management structure of the sick units as well as initiate the merger of a sick company with a healthy company when both parties are willing. It can also take over the management of a sick unit upon itself. BIFR has to prepare a scheme under Section 18(1) of the Sick Industrial Companies Act, (Sica) 1985 for the TO of a sick unit by a healthy unit. According to Section 32(2) of Sica, the powers of the Central Government under Section 72A of Income Tax Act 1961 will be exercisable by BIFR in cases where it has sanctioned an amalgamation with a healthy unit. A number of such mergers and TOs have been worked out or approved by BIFR.

On 16 May 1997, the Union Minister of Finance, Mr. P. Chidambaram introduced the Sick Industrial Companies (Special Provisions) Bill, 1997, in an effort to completely recast Sica 1985 with a view to expediting the revival of sick companies and arresting the problem of growing industrial sickness. Salient features of the new bill are given below (CMIE (1997b):

* A change in the definition of industrial sickness has been envisaged, whereby a company which repeatedly defaults on debt payments will now be deemed as sick instead of the earlier criterion, where full erosion of net worth was used as the thumb rule. A company is deemed sick if it defaults in repaying
secured creditors the principal or interest for four quarters in two successive years.

**There are two categories of reference to the BIFR: voluntary and mandatory. Reference of a sick company to the BIFR will be mandatory within 60 days from the finalization of the audited accounts in case where the company has accumulated losses amounting to more than 50% of its net worth during the immediately preceding four financial years. Voluntary reference would imply that any company, which has defaulted on its bank payments for three consecutive years would be registered with BIFR.**

**The role of BIFR will now be limited to that of a mediator between a sick company and its creditors, replacing the earlier system where the BIFR would function as a quasi-judicial body. The BIFR’s intervention has also been made optional, although the bill empowers the BIFR to attempt outright sale of a sick unit if all revival attempts fail.**

**Time-bound frame for the rehabilitation strategies of sick companies is suggested in order to expedite the revival process. BIFR will prescribe time limits for a three-stage revival plan. The time limit for each stage of revival of a sick company will be decided by the BIFR.**

In the first stage, the promoters would play the key role. Within 15 days from the date of reference, the board would direct promoters of sick companies to submit their revival package in consultation with the financial institutions. This has to be endorsed by BIFR to be made effective.

If a solution is not forthcoming, BIFR will formulate a revival strategy in consultation with the secured creditors. If the package is supported by all concerned parties, then BIFR will accept it.

If the first two fail, the final stage is when BIFR direct the secured creditors to formulate a revival strategy. At least 75% of the secured creditors should endorse a package for it to be accepted by BIFR. The Act withdraws the veto powers of any single secured creditor.

If no viable package emerges after these three stages, the company would have to be sold as a going concern. The board may distribute the sale proceeds to the entitled parties instead of going through the High Courts for the distribution of the sale proceeds. All these have to be completed within a specified time limit set by BIFR.

In case, BIFR fails to find any buyer for the sick company, it may direct the company to be wound up and accordingly forward its opinion to the concerned High Court.
* In case, all attempts by the BIFR to find a buyer for the sick company fails, it may direct the company to be wound up and accordingly forward its opinion to the concerned High Court.

* Appellate Authority for Industrial and Financial Reconstruction (AAIFR) will be abolished. Companies seeking to appeal against the BIFR’s decision will now have to approach the high court.

**Mergers under BIFR Provision**
A sample of such mergers and acquisitions has been provided in *Appendix 3.1* of Chapter 3. It includes mergers and acquisitions between private companies, public companies as well as public and private companies. The sample shows that the majority of consolidations under BIFR fall in the class of mergers, mainly the inter-group ones. There have also been some cases of TOs in the form of outright sale of companies. However, there is only one case of sale of assets of a BIFR company to a healthy company.

**Case Study**

**Asea Brown Boveri Ltd. - ACC Babcock Ltd. TO**
Asea Brown Boveri Ltd. (ABB), the Swiss-Swedish multinational engineering giant took over ACC Babcock Ltd. (ABL), an ailing subsidiary of Babcock Energy Ltd (BEL) of UK. ABL was one of only two firms that made boilers for power stations in India, the other being BHEL. ABL was a BIFR company. It made an accumulated loss of Rs. 109 crore by March 1994 on an equity of Rs. 2.95 crore, and a negative net worth of Rs. 105 crore. ABL, which had 2 units, one in Durgapur and another in Sahabad in Karnata, was declared sick in 1986 and was revived in 1989. The offer made in 1993 by ABB to buy up ABL was finally approved by BIFR in 1995. ABB took over the management of ABL by acquiring 76% of ABL’s enhanced equity capital. The power ministry and FIs would hold 22%. A nominal 2% and 1% equity would be held by ACC and Babcock respectively. TO was sanctioned by BIFR under the merger-cum-rehabilitation scheme and transfer of ABL to ABB was formalised on 21.8.1995. The merged company was named ABB ABL Ltd. For ABB, it was a part of its growth strategy, to invest $ 300 million between 1993 and 1998 in mergers, acquisitions, joint ventures, modernisation and expansion of existing facilities. ABB makes neither boilers, turbines nor generators, the three key elements of a power plant. This acquisition added boilers to ABB’s product portfolio and plugged a vital gap in ABB’s range of capabilities in meeting India’s growing demand for turnkey power plants (ABB’s turbine and generator facility was then coming up at Baroda). ABBL intended to modernise the sick ABL and make it of global standards [17].

**Flowmore Polyesters Ltd. - SRF merger**
Flowmore Polyesters Ltd. (FPL), a sick company with accumulated losses of close to Rs. 14 crore merged with SRF. FPL never went into the commercial production of the intended products (manufacture of international quality packaging and audio grade films). The ostentible reasons sighted were poor management and lack of adequate technology. It came before the BIFR for a revival package in November 1991. What is more interesting about this merger is that SRF has foregone all tax benefits
amounting to Rs. 10.16 crore arising out of the merger of a healthy company with a sick company under Section 72 A of the Income Tax Act, 1961, which is usually not the case. SRF had accepted in unequivocal terms the merger conditions and categorically committed to not go in for legal action in any judicial forum to claim the said tax benefits at a later date [18].

7.2.5 Liberalized Regime and Companies Act, 1956

The policy initiatives since 1991 have changed the corporate environment. There is also an ongoing discussion on Corporate Governance (CG) mechanism suitable for India (we will go into this issue in Chapter 9). The Companies Act, 1956 (and its subsequent amendments) gives the general framework for the discussion.

Companies Act before 1991

Companies Act 1956 (Taxmann (1997)) was incorporated to regulate and control the operational aspects of the industries. The Companies Act, 1956 defined public companies in terms of Section 3(1) (iii, iv), by which public companies actually indulge in inviting public to subscribe to their shares and debentures in the stock market.

Mergers and the Companies Act

According to the Companies Act, mergers and amalgamations are distinct business combinations that differ from a holding company. Section 4 of the CA 1956, defines the “holding company” and “subsidiary” which are relevant in the analysis of mergers. The main criteria of becoming a holding company is the control in the composition of the board of directors in another company and such control should emerge from holding equity shares and thereby more than 50% of the total voting power of such company.

Mergers and amalgamations constitute a major subject matter of the Companies Act, 1956 and the courts of law, and there are well laid down procedures for valuation of shares and protection of the rights of investors. Merger can be achieved by following different means such as purchase of assets or shares of a target company or by means of scheme of arrangement following the procedure laid down by the Companies Act, under Sections 391 to 396 and Section 111. The provisions of Section 391 to 394 of the Companies Act, 1956 provide a vehicle for amalgamation of two or more new companies. Companies Act 1956, vide Sections 394 and 396A explain amalgamation. The sections 391 to 391 are basic and provisions in Section 395, 396 and 396A are supplementary in the matters of amalgamation. The nature of coverage under these sections is as follows:

Section 391: Under this section a company can compromise or make an arrangement with its creditors or members. The court has the power to sanction or reject any such scheme of compromise or arrangement. Section 392: This section empowers the court to give such directions in regard to any matter or make such modification in the compromise or arrangement as it may
consider necessary for the proper working of the scheme. The court can modify the
scheme at the instance of any shareholder. However, the court has no power to
modify the scheme pronounced but not sanctioned by the High Court before the date
of the government notification of the company as a relief undertaking.

Section 393: This provides supportive provisions for compliance such as providing a
statement stating the terms of compromise or arrangement and explaining its effect
along with the notice calling the meeting. In case the notice is advertised, then it
should specify the venue and the manner in which members attending the meeting
can obtain copies of the statement of compromise or arrangement. The refusal to
supply particulars is punishable with fine.

Section 394: It is the main section, which deals with the reconstruction of and
amalgamation of companies. Under this section, the court may make provisions for
the transfer of the whole or any part of the undertaking, property or liability of any
transferor company to the transferee company.

Section 395: It provides for the compulsory acquisition by the transferee company of
shares of the dissenting minority of shareholders for scheme or contract approved by
majority of shareholders. The shares may be acquired on the same terms as those
offered for the shares of the approving shareholders. However, this requires approval
of not less than nine-tenths of the value of the shares whose transfer is involved. This
does not include the shares already held by the transferee company or its nominee or
subsidiary. Section 395 thus provides adequate safeguard to the rights of dissenting
shareholders.

Section 396: This section outlines the power of the central government to provide for
an amalgamation in national interest. Further, under Section 396A, the books and
papers of a company which has been amalgamated with, or whose shares have been
acquired by another company shall not be disposed of without the prior permission of
the Central Government and before granting such permission the Government may
appoint a person to examine the books and papers or any of them to ascertain where
there is any evidence of offence in connection with the formation or promotion, or the
management of the affairs in the process of amalgamation.

Section 111: Under this section, the board of directors of a company has been vested
with powers to refuse registration the transfer of shares acquired by the acquirer in
certain circumstances – under apprehension of acquisition bids or corporate raids.
The Company Law Board has the power to decide on the matter. Refusal can be made
on two issues: that the transfer is against the interests of the company or against
public interest. Company Law Board did not allow the transfer of shares in the case
of Manu Chhabria’s efforts to TO Gammon India Ltd. as it was felt that the transfer
would result in concentration of economic power which was against the spirit of the
MRTP Act [19].

Apart from Section 111, which provides for outright refusal to transfer shares,
Companies Act has also imposed certain restrictions on large-scale acquisition of
shares and share transactions. For instance, if anybody acquired large volume of
shares it is obligatory to notify the incumbent management. Two or more group companies may acquire shares of each other in large quantity or one company may distribute shares to the shareholders of its group company to avoid threats of TO bids. Such companies shall fall within the same management control and attract provisions of Section 372 of the CA, 1956. Boards of directors make the chances of any acquisition bid dim by making the possession of the company’s assets less attractive. This is possibly done by putting the assets by entering into various types of financial arrangements like sale and lease back, mortgage of assets to financial institutions for long-term loans, keeping the assets in trust for security of debenture loan, etc. This is done with the specific approval of shareholders in their annual general meetings in pursuance of Sections 293 (1)(a) and (d) of the CA, 1956. Sections 372 and 108 of the Companies Act put limits on the extent of equity purchasable by a company of other companies and refusal to register transfer of shares by the board of directors of the target company for reasons “in the interest” of the company. Such measures under Companies Act effectively controlled TOs, especially hostile TOs.

**TOs and the Companies Act**

One of the early attempts of providing an effective set of laws governing the TOs of listed companies came from the stock exchanges. Section 73 of the Companies Act, 1956 requires a company going public to make application for enlistment of the securities at the recognised stock exchange. Sebi also has powers under Section 21 of the Securities Contract (Regulation) Act (SCRA), 1956 to compel listing of securities by public companies. However, it is important to note at the very outset that all regulations concerning TOs in India (be it the Clause 40 (A&B) in the Listing Agreement [20], or the Sebi Regulations for substantial Acquisition of Shares and TOs (1994 & 1996)) do not include mergers and amalgamations within their ambit.

TOs were governed by Section 22-A of the Securities Contract Regulation Act (SCRA), and Sections 111, 250 and 409 of the Companies Act, 1956 [21]. Section 22-A of the SCRA vested powers with the managements of companies to refuse transfer of shares — effectively a veto power — in the event of a perceived hostile TO. It provided that a company whose shares are listed on a recognised stock exchange may refuse to register the transfer of any securities on any one or more grounds specified in this section. These included diverse factors, some of which are as follow [22]:

- The instrument of transfer is not proper or has not been duly stamped and executed.
- The certificate relating to the security has not been delivered to the company or that any other requirements relating to registration has not complied with.
- The transfer could result in contravention of any of the existing laws, rules, and any administrative instructions or conditions of listing agreement.
- The transfer would result in changes in the composition of the board of directors, which in turn would be prejudicial to the interests of the company (leading to a change in management) or to the public interest.
If the transfer is prohibited by a court of law, among others.

If the transfer was refused as the instrument was not duly stamped and executed or the certificate was not delivered to the company, the section entailed that the company should inform the concerned parties. If the refusal was based on the other three grounds, a reference to the Company Law Board (CLB) was required. The next step was that the CLB would give a reasonable notice to the company and to both the parties to make a written representation. Later it would issue directions for registration or declare that the transfer need not be registered. The CLB had the powers to decide on the matter ultimately.

As per Section 111 of the Companies Act [24], if companies refuse to register transfer of shares, they have to, within two months, send notice of the refusal -- and the reasons for it -- to the transferee and the transferor or to the person giving intimation of the transmission. The transferor or transferee may then appeal to CLB against any refusal by the company to register the transfer or against any failure of the company to either register the shares or send a notice within two months. Moreover, if the name of any person is without sufficient cause entered or deleted from the list of shareholders; or a default/unnecessary delay is made in registering the transfer, the aggrieved party can approach the CLB for rectification of the register.

Section 250 of the Companies Act allows company managements and promoters to go to CLB and prevent any TOs, normally on the grounds that TOs would be prejudicial to both shareholders and the public interest; this is normally used when the process of transfer of ownership of a substantial block of shares is underway. However, it is observed that the whole definition of public interest is a very hazy one, which changes over time, especially in a liberalising economy.

Companies used Section 22-A to prevent any transfer of shares; once the shares were actually transferred to the hostile raider, the only recourse that company board of directors had was to appeal to the CLB under Section 250 of the Companies Act. If the board of directors was changed, the managing director could also move the CLB on similar grounds. If the TO conforms to the guidelines of the Sebi code, there is little CLB or promoters could do.

Amendments in Companies Act after 1991 and Implications on Corporate Consolidation Activities in India

The Companies Act 1956 had gone through a number of amendments till 1996 that strongly recommended the increased role of mergers and TOs in India as forces of corporate restructuring. In 1996, that the Government of India set up a Working group to rewrite the Companies Act. Accordingly, the 8-member Working Group (1997a) was constituted in August 1996 and the Companies Bill was presented to the Parliament for public debate in 1997. On going through the Report of the Working Group it becomes explicit that the various recommendations and suggested measures by the Group, aimed at the liberalization and streamlining of laws, advocated mergers and TOs in India as instrument to corporate growth. Thus the views of the Group seem to be in line with the Anglo-American position that assigns important role to merger and acquisition activities in fostering corporate growth. These issues raised in
this subsection on the suggestions and prescriptions made by the Working Group on Companies Act will be further discussed in Chapter 9 which deals with CG in India.

7.2.6 Sebi TO Regulations and TOs

The Sebi (Substantial Acquisition of Shares and TOs) Regulations, 1994, (Code), which was notified on 4.11.1994, owes its origin to a draft consultative paper prepared in 1991 [25]. It was a comprehensive set of rules to govern merger and TO activities in India. The main objective of the TO code was to protect the rights of and ensure fair treatment to the small shareholders and to bring about transparency in TOs.

In September 1995, several disparate buy-outs helped bring into sharper focus the rapidly changing profile of the merger and acquisition activities in India that presumably may have stimulated the revision of the TO Regulations in India by Sebi in 1997. One such case was the Torrent versus Bombay Dyeing bid for Ahmedabad Electric Corporation (AEC). The special feature of this TO was that it was the first ever, openly contested TO battle. In August 1995, Torrent made an open offer for 20% of AEC’s equity at Rs. 65 per share. Before opening the bid, Bombay Dyeing offered for 50% of AEC at Rs. 90 per share. Sebi guidelines permit competitive bids within 14 days of public announcement. Bombay Dyeing had violated this guideline and so Sebi rejected the bid. Bombay Dyeing appealed to the Finance Ministry. Meanwhile share prices of AEC rose to Rs. 200. Torrent’s revised bid at Rs. 132 per share had no takers. In the mean time Bombay Dyeing’s bid failed and the share price declined to Rs. 80 [26].

Sebi (Substantial Acquisition of Shares and Takeovers) Regulation, 1997

Sebi appointed a committee under the chairmanship of Justice P.N. Bhagwati to review the Sebi (Substantial Acquisition of Shares and TOs) Regulation, 1994. The draft report was released on 28 August 1996. On 30 January, 1997, the Sebi board approved the TO code prepared on the basis of the recommendations of the reconstituted Bhagwati Committee. The TO code was applicable under the following situations:

* Crossing the threshold limit of 10% shareholding
* Change in control, irrespective of shareholding
* Purchases in excess of the creeping acquisition limit
* Not applicable to purchases by a person already holding more than 51% in the company.

The definition of “control” proposed in the draft regulations were to be suitably modified to make it more precise and comprehensive. The obligations of the board of the target company were spelt out. In particular, during the offer period, the board of the target company is precluded for inducting into the board any person belonging to
the acquirer or transfer shares in their name till after completion of all formalities relating to the offer.

The new code allowed the acquisition by exchange of shares. However, if the acquirer offers cash to any section of the shareholders, it should offer cash to all. The acquirer was required to make a public offer for a minimum of 20% and disclose additional details such as financial arrangements to honour the offer. The raider has to reveal whether the funds come from domestic or foreign sources (including NRIs). This requirement is included in the new TO code possibly to enable the market regulators to effectively track the people or entities who are behind a TO raid.

The pricing was based on parameters such as negotiated price, average of high/low price for the preceding 26 weeks, the highest price paid by the acquirer for open market purchases in the last 26 weeks and price for preferential offers, if any. The minimum offer price stipulates that all investors get the same price which should not be less than the 26-week average of the high and low prices. Exemptions were possible but Sebi was to be guided by the recommendations of a panel.

The code attempted in eliminating non-serious and frivolous bids by its stipulation of 10% of the probable price of the acquisition to be deposited in the escrow account and forfeited if the acquirer is unable to meet its obligations within 30 days.

Conditional offers had now been allowed, subject to either the minimum mandatory acceptance of 20% with differential pricing, or with a deposit of 50% of the value of the offer in cash in the escrow account.

Acquirers who held more than 10% but less than 51% are permitted to make creeping acquisitions of 2% of stock in any 12-month period. Any purchase by a person holding more than 51% has to be made in a transparent manner, through a public tender offer.

The mandatory public offer is triggered when the threshold limit of 10% is crossed and when there is a change in control. The acquirer, including the existing management, should make a public offer to acquire a minimum of 20% in case the conditions for mandatory public offer mentioned are attracted.

The code brings all indirect TOs made through unlisted companies and investment companies under the purview of the code. According to the final draft of the TO code, acquisition of an unlisted company would not be exempted if by virtue of such acquisition, or change in control of the unlisted company whether in India or abroad, a change is brought about in the control of the listed company or in the voting rights of the listed company. The Mitsui TO of Sesa Goa brings into focus the issue of indirect TOs through acquisition of foreign holding companies and unlisted companies [27].

The TO code was further changed in October 1998 on the basis of the recommendations of the reconstituted Bhagwati Committee. Under this revised regulation, the provision of a creeping acquisition, the limit of which per year is
raised from earlier 2% in any period of 12 months to 5% of the total equity of the company, through amendments of sub regulation (1) and (2) of Regulation 11. This provision of creeping acquisition is extended to even those who are holding more than 51% stake in a company, but should be below 75%. The threshold limit to trigger the TO code has also been raised from earlier 10% to 15%, through amendment of Regulation 10. Upon acquiring 2% disclosures are to be made to stock exchanges. These are some of the major changes in the latest TO code (Economic Survey (1998-99: 53)). Table 7.6 below shows some of the major differences between the provisions of the earlier guidelines and the new TO code.

### Table 7.6

<table>
<thead>
<tr>
<th>Serial Number</th>
<th>Issues</th>
<th>Old Guidelines</th>
<th>New Guidelines</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Consolidation of holdings</td>
<td>Not permitted</td>
<td>Allowed</td>
</tr>
<tr>
<td>2.</td>
<td>Competitive bids</td>
<td>14 days</td>
<td>21 days</td>
</tr>
<tr>
<td>3.</td>
<td>Change in management control</td>
<td>Ignored</td>
<td>Trigger open offer</td>
</tr>
<tr>
<td>4.</td>
<td>Substantial change in shareholding</td>
<td>Ignored</td>
<td>Trigger open offer</td>
</tr>
<tr>
<td>5.</td>
<td>Disclosure norms</td>
<td>Not defined</td>
<td>Laid down</td>
</tr>
<tr>
<td>6.</td>
<td>Offer to acquire</td>
<td>Up to 80% allowed</td>
<td>Up to 100% allowed</td>
</tr>
<tr>
<td>7.</td>
<td>Date for offer</td>
<td>Requirement of record date</td>
<td>Allowed to choose specific date</td>
</tr>
<tr>
<td>8.</td>
<td>Down payment</td>
<td>Not needed</td>
<td>10% offer to be deposited up front in escrow account</td>
</tr>
<tr>
<td>9.</td>
<td>Management change during open offer</td>
<td>Possible</td>
<td>Not permitted</td>
</tr>
<tr>
<td>10.</td>
<td>Disclosure of financing mode</td>
<td>Not required</td>
<td>Mandatory</td>
</tr>
<tr>
<td>11.</td>
<td>Bid at higher price</td>
<td>Sebi permission needed</td>
<td>Bid at higher price or for more shares cleared</td>
</tr>
<tr>
<td>12.</td>
<td>Post-offer market purchase</td>
<td>Ambiguous</td>
<td>Must match offer price</td>
</tr>
<tr>
<td>13.</td>
<td>Offer price based on</td>
<td>Negotiation/Six-month average</td>
<td>Highest price paid by acquirer in last 12 months included</td>
</tr>
<tr>
<td>14.</td>
<td>Offer letter</td>
<td>Vetted by Sebi</td>
<td>To be filed only with Sebi</td>
</tr>
<tr>
<td>15.</td>
<td>Notice for public offer</td>
<td>24 hour to Sebi</td>
<td>Two working days</td>
</tr>
<tr>
<td>16.</td>
<td>Open offer applicable for</td>
<td>Four weeks</td>
<td>30 days</td>
</tr>
<tr>
<td>17.</td>
<td>Public announcement in</td>
<td>Two newspapers</td>
<td>Three newspapers</td>
</tr>
<tr>
<td>18.</td>
<td>Recommendations from directors</td>
<td>Unclear</td>
<td>Permitted</td>
</tr>
</tbody>
</table>
On the whole, the current Sebi Regulations, by making disclosure of substantial acquisitions mandatory, have sought to ensure that the equity of a firm does not covertly change hands between the acquirer and promoters. Moreover, the rights of existing management to withhold transfer of shares have been withdrawn, although under Sections 250 and 409 of the Companies Act, target companies can shelter against raiders if the proposed transfer prejudicially affects the interests of the company. The revised Sebi TO Regulations together with revisions in the Companies Act can thus be expected to provide a balanced operation of the market for corporate control in India with a level playing field for the principal and the agents.

7.3 Summing Up

The standard economic and apparently non-economic factors that we have discussed in Chapter 4 must have definitely played a significant role in promoting mergers and TOs in India in the 1990s. But these factors could get a trigger through various institutional changes that occurred in India with the economic reforms programme in 1991. Therefore, in order to understand the underlying factors promoting mergers and acquisitions in the post-NIP period, we need to have a perception of the economic policies in general, and capital market policies, foreign investment policies and industrial policies, in particular, prior to and after the initiation of economic reforms in India. In other words, there is a need to study the macro-economic perspective of the economy for a meaningful analysis of mergers and TOs in India in the post-liberalization regime. We have done exactly this in this chapter and the preceding two. The effects of changes in the laws governing the capital structure of the firms and those pertaining to foreign investment and trade on the pattern of merger behaviour in India have already been discussed in the last two chapters. In this chapter we have concentrated on the other policy changes in India e.g., the delicensing, MRTP deregulation, changes in laws governing sick firms, the role of Sebi, etc. that have promoted mergers and acquisitions in India over 1994 to 1998. These three chapters together is hoped to enable one to develop an idea of how the prevailing economic, institutional and policy environment in India has been instrumental in the realisation of the basic motivational factors inducing the recent mergers and TOs in India.

However, a study of just the causes behind the corporate consolidation activities is not enough for a complete review of the status of the prevailing mergers and acquisitions in India. For the present study to attain a formal completion requires an assessment of the consequences of the ongoing merger and TO activities on the general economic and corporate health of the country. The next chapter concentrates on this particular issue.
NOTES AND REFERENCES

1. The SCRA provisions in Section 22A give the power of monitoring share transfers to the Company Law Board, particularly in case of a transfer of securities that is likely to result in change in the composition of the board of directors as would be prejudicial to the interests of the company or to the public interest.

"DCA, SEBI on collision course over Takeover norms", *Economic Times*, 17.11.1994.

2. In 1995, the Torrent group made an open offer for Ahmedabad Electricity Corporation (AEC). Initially, the TO of the AEC appeared to be a mere formality. However, Bombay Dyeing made an unprecedented competitive bid and even though it finally lost out, it made the TO twice as expensive for Torrent. This incidence also showed up a number of deficiencies in the existing procedures.

To rectify these deficiencies in the system, Sebi, in the end of 1995, appointed a committee, headed by P. N. Bhagwati, former Chief Justice of India, to review and revise the 1994 TO code and recommend changes. The draft TO code formulated by the Committee was released on 28.8.1996. With the avowed aim of protecting the interests of shareholders, transparency and equity, without discouraging the process of TOs, the Committee sought to provide an orderly framework of regulations in which TOs could occur.


3. These 38 "scheduled" industries included defence industries, capital goods, metals, fuels, telecommunications, transport, fertilisers, chemicals, cement, timber, rubber, glass, ceramics, besides a host of consumer goods like textiles, drugs, paper, sugar, food and leather products.

4. The post-1985 delicensing measures came in small bits, viz.:

streamlining of licensing system via exemption from licensing of 45 industries, delicensing of industries under IDR Act extended from 27 to 82 bulk drug industries, delicensing extended to MRTP/FERA companies, etc.,

automatic re-endorsement of licensed capacities (to enable industrial enterprises to maximise their production through optimum utilisation of their installed capacity) on the basis of past production, introduced in April 1988,

industrial licences no longer required for firms with assets below Rs. 5 crores (revised to Rs. 15 crores in 1988) and located at least 30 miles from urban areas as well as in 25 broad industry groups.
modernisation of equipment resulting in an increase of up to 49% of licenced capacity also no longer required an additional licence.

5. Annexure I of the NIP Statement gives list of 6 industries reserved for public sector. These are:

1. arms and ammunition and allied defence equipment
2. atomic energy
3. coal and lignite
4. mineral oils
5. minerals
6. railway transport

Even this list has been pruned. As per National Mineral Policy, 1993, minerals and mineral-bearing areas have been de-reserved in respect of 13 minerals, namely, iron ore, manganese ore, chrome ore, gypsum, sulphur, gold, diamond, copper, lead, zinc, tin, molybdenum and wolfram.

6. Industrial licensing was abolished in 1991 for all projects except for a limited number of 18 industries related to security and strategic concerns, social reasons, hazardous chemicals, overriding environmental reasons and luxury consumption goods, included in Annexure II of the policy statement. The 18 industries for which licensing was compulsory were:

1. coal and lignite
2. petroleum (other than crude) and its distillation products
3. distillation and brewing of alcoholic drinks
4. sugar
5. animal fats and oils
6. cigars and cigarettes of tobacco and manufactured tobacco substitutes
7. asbestos and asbestos-based products
8. plywood, decorative veneers and other wood-based products such as particle board, medium density fibre board, block board
9. raw hides and skins, leather, chamois leather and patent leather
10. tanned or dressed furskins
11. motor cars
12. paper and newsprint except bagasse-based units
13. electronic aerospace and defence equipment: all types
14. industrial explosives including detonating fuse, safety fuse, gun powder, nitrocellulose and matches
15. hazardous chemicals
16. drugs and pharmaceuticals (according to Drug Policy)
17. entertainment electronics (TVs, CD players, tape recorders)
18. white goods (domestic refrigerators, domestic dishwashing machines, programmable, domestic washing machines, microwave ovens, airconditioners).
Plywood products, motor cars, consumer electronics and white goods have been subsequently removed from the list.

As of June 1989 industrial licensing was compulsory for 27 industries. Of these, only 11 remain in the above list, namely, numbers 1, 3, 4, 5, 7, 8, 9, 11, 13, 14 and 15. Seven new industries (which were not there in the above 27, named against numbers 2, 6, 10, 17 and 18) were added by the 1991 change.

On the other hand, 16 of the 27 industries do not figure in the new list. These are:
- textiles, milk foods, etc.,
- matches,
- slitting/confectionery of photo-sensitised material for jumbo rolls,
- telecommunication equipment,
- computer peripherals,
- microprocessor-based industrial control instrumentation system
- and 8 to 16 different types of metal-based products relating to 9 industries.

7. In the NIP 1991, no industrial licensing was required if following conditions were fulfilled:

* industry is not in Annexure I or II
* product is not reserved for small-scale industries
* the project is not located within 25 kilometres of the standard urban area limits of a city having population of more than 10 lakhs as per 1991 census. There are 23 such cities in India, having population over 10 lakhs. This restriction of location was not applicable to electronics, computer software, printing and other non-polluting industries as may be notified.
* these provisions were applicable to "substantial expansion" also, which meant increase in capacity by more than 25% of existing capacity.

8. The Government has been following a policy of reservation of items for exclusive development of the small scale sector. This is evident from the table below.

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of SSI units</th>
</tr>
</thead>
<tbody>
<tr>
<td>1972</td>
<td>177</td>
</tr>
<tr>
<td>1983</td>
<td>837</td>
</tr>
<tr>
<td>1988</td>
<td>305000</td>
</tr>
<tr>
<td>1991-92</td>
<td>2080000</td>
</tr>
</tbody>
</table>


9. As a result of the liberalisation of industrial controls during 1985 and 1986, the definition of MRTP firms was relaxed to assets exceeding Rs. 100 crores and about 30 priority industries were exempted from the scope of the Act.
10. The term “inter-connected units” is defined as follows:

* if one company owned or controlled the others, or
* they are all owned by one or more individuals, or by some other firm(s) having at least one common partner.

Refer to Tandon and Tandon (1997: 384).

11. The 1984 amendment brought into the Act the provisions for the regulation of unfair trade practices and created a new authority of the Director General of Investigation and Registration, replacing the twin authorities of the Director of Investigations and the Registrar of Restrictive Trade Agreements.

Refer to Sandesara (1994: 2083).


Also refer to:


13. Sunil Mani has pointed out that, this policy of more or less across-the-board delicensing coupled with fixing capacities at pre-determined levels are bound to be contradictory and cannot be expected to result in any significant increase in competition among firms. He proceeds by explaining the aspects of MES and justifies his hypothesis as an implication that follows from the explanation.

* For all the 72 industries, the MES has been fixed at a unique point. Implicit in this, is the assumption that the long-run average cost curve is “U” shaped as suggested by traditional neo-classical theory, so that there is a unique point where all costs are minimised.

* Second, it also makes the added assumption that there are significant economies of scale in the chosen industries.
Mani argues that if it can be justified that both these assumptions are counter-factual, then the policy of fixing the MES at unique levels becomes highly questionable.

He argues that it has been shown through empirical studies that the long-run average cost curve is “L” shaped, meaning thereby that is a range of output, for which the costs are minimum. If this was so, the government ought to have fixed the MES within a range and not at a unique point.

Second, technological changes which have been quite central to most industries of the modern world, have rendered the existence of economies of scale in most industries less significant. Hence this proposition will hold good only for a select number of industries.

Given this, fixing the MES at such unique and often enough at very high levels is tantamount to erecting a capital barrier to entry in those industries where economies of scale do not exist or are not significant enough. This is because at such pre-determined capacities, the cost of setting up/creating such plants is so high that only a few entrepreneurs can enter, and that too only with the financial support of the FIs. It becomes easier for existing firms to expand to such capacities than for fresh units to come up. This would mean persistence of concentration in already concentrated sectors.


14. The Arjun Sengupta Committee was set up by the government to look into the ailments of the public sector units and to devise a remedial strategy. It gave its recommendations in May 1986. It emphasized the need for striking the right balance between autonomy and accountability. In the issue of the requisite degree of autonomy, the Committee recommended the “holding company” structure for core sector units like steel, coal, power and fertilizer. Different companies functioning in these core sectors could be designated “subsidiary” companies and given operational autonomy under the overall control and policy guidelines for the holding company. The Committee also suggested the government to enter into a 5-year Memorandum of Understanding (MOU), with the board of the holding company. It was to be the duty of the holding company to control the day-to-day operations of the respective subsidiary companies. Some of the recommendations of this Committee were adopted by the government in its future attempt to the restructuring of public sector units.

15. The Chakravarty Committee Report of 1987 suggested that public enterprises could be made more profitable and more productive if a macroeconomic strategy of growth was followed in which the fuller exploitation of capacities of public enterprises in all sectors of the economy played an important role. The report envisaged the linking up of public sector enterprises through a process of mutual demand generation and supply support. Such a strategy would be a necessary part of a programme of better integration of public enterprises in the national economy.


Also refer to:


"We will take equity in fast track projects", Economic Times, 24.1.1995.


“ABB registers Rs 62.52-cr net, declares 40 p.c.”, Economic Times, 23.2.1996.


20. Companies seeking listing, have to enter into an agreement known as “listing agreement” as prescribed under the Securities Contract (Regulation) Act, 1957. The first attempts at regulating TOs were made in a limited way by incorporating Clause 40 (A&B) of the Listing Agreement of the individual companies with the stock exchanges. In fact, these were the only provisions that directly regulated TOs. The provisions under the listing agreements have been made to protect the interest of investors and shareholders by providing maximum information about TO bids.

The clause 40 of the listing agreement initially provided for making a public offer to the shareholders of a company by any person who sought to acquire 25% or more of a company. This allowed for the participation of shareholders of the company that is being taken over, in the TO process. If the purchaser was not a listed company, however, then this clause on disclosure could not be enforced.

Clause 40 of the Listing Agreement relates to acquisition of shares and has been amended by introducing clauses 40A and 40B. The spirit of clauses 40A and 40B is to bring about a greater degree of transparency in corporate TOs and protect the interest of the small investors who could get the benefit of a good price.

The listing agreement vide clause 40A prescribes norms of disclosures by the company in the event of substantial acquisition of shares by any person in that company and requires the offeree to inform the stock exchange when such acquisition results in an increase in the shareholding of the acquirer to more than 10%. Clause 40B deals with the TO offers. In a TO offer made to the listed company or by such listed company, clause 40B prescribes certain norms to be complied with mandatorily. A TO offer refers to a change in the management.

Where there is no change in the management, clause 40B of the Listing Agreement would not apply. However, sub-clause 13 of the amendment of clause 40B also provides an exemption to the schemes approved by BIFR. There is no provision under clause 40B for exemption of non-BIFR sick companies.

**Deficiency of Clause 40**
Although Clause 40 (A&B) was the only provision which directly regulated TOs, yet it suffered from several deficiencies particularly in its limited applicability and weak enforceability for several reasons.

* Being a Listing Agreement, it could be made binding only on the listed companies and could not be effectively enforced against an acquirer unless the acquirer itself was a listed company.

* The Listing Agreement was not a law which needed compliance and its contravention did not attract serious penal consequences. The
penalty for all non-compliance was one common to all violations of a listing agreement, namely, delisting of the company's shares which ran contrary to the interest of investors.

* The manner in which these were drafted, left considerable scope for circumvention. The acquirers could frustrate the basic purpose of the clause, simply by acquiring voting rights little below the threshold limit of 25% for making a public offer.

* Besides, it was also being observed that in practice, it was possible to acquire control over a company in the Indian context with even holding 10% directly, (e.g., Tatas in Tisco).

**Amendment of Clause 40**

There was therefore a case for lowering the threshold from 25%. In 1990, even before Sebi became a statutory body, the Government in consultation with Sebi, amended Clause 40 (A&B) by

* lowering the threshold acquisition level for making a public offer by the acquirer, from 25% to 10%;

* bringing within its fold the aspect of change in management control under certain circumstances (even without acquisition of shares beyond the threshold limit), as a sufficient ground for making a public offer;

* introducing the requirement of acquiring a minimum of 20% from the shareholders;

* stipulating a minimum price at which an offer could be made;

* providing for disclosure requirements through a mandatory public announcement followed by mailing of an offer document with adequate disclosures to the shareholders of the company; and

* by requiring any acquirer to disclose its shareholding at 5% level to serve as an advance notice to the target company about the possible TO threats.

These changes were aimed at making the process of acquisition of shares and TOs transparent, providing for protection of investors' interests in greater measure and introducing an element of equity between the various parties concerned by increasing the disclosure requirement.

The amended clause was unable to provide a comprehensive regulatory framework governing TOs; nonetheless, it made a positive beginning. Other than this clause, there were several provisions spread over various laws dealing with TOs, e.g., Section 81 A of the Companies Act, 1956.
Refer to:


22. The first proposal to restrict the powers of promoters in refusing transfer of shares was made in 1985, when the chairman of Sebi, Dr. D.R. mehta was the Controller of Capital Issues. It reportedly met with oppositions from industrialists and the department of company affairs of the ministry of finance. Since then, promoters have used Section 22-A of the SCRA, and other methods like preferential allotments of shares to promoters at below market rates of interest, to keep control.


24. “Share transfer norms to apply to unlisted companies”, *Economic Times*, 22.9.1994. Also refer to:


Also refer to:


“For the Kind Attention of the Equity Shareholders of the Ahmedabad Electricity Company Ltd.”, *Statesman*, 27.9.1995.

“Clamouring for the cake”, *Telegraph*, 2.10.1995.


"Gujarat, FIIs, individual investors cold to Torrent's offer for AEC", *Economic Times*, 7.11.1995.


"Torrent group set to stake claim to AEC", *Economic Times*, 26.1.1996.


27. Mitsui’s subsidiary Early Guard acquired Finsider International of UK which in turn holds a 51% stake in Sesa Goa. Mitsui told Sebi that its acquisition of Sesa Goa did not fall under the purview of the TO code since it was a overseas transaction. Mitsui contended that the Sebi Act and the TO code only apply to companies registered under the Indian Companies Act and listed on the Indian stock exchanges. Sesa Goa also echoed Mitsui’s view. However, a minority shareholder filed a writ petition that Mitsui made a public offer to the shareholders of Sesa Goa after its TO. Meanwhile, Sebi sent a notice to Sesa Goa seeking details of its shareholding pattern, the change in its management, and the composition of the company’s board during the preceding three years.

On March 6, 1997, Sebi acquitted Mitsui of the charges of violating its old TO regulations while assuming control of Sesa Goa through its holding company, Finsider International.