Chapter-V
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Securities Exchange Board of India (SEBI)

The SEBI was established on April 12, 1988 through an administrative order, but it became a statutory and really powerful organisation only in 1992 when CICA was repealed and the office of the Controller of Capital Issues was abolished. Government of India (GOI) issued an ordinance on 30th Jan 1992 and pursuant to this ordinance SEBI was set up on 21st Feb 1992. The SEBI Act replaced this ordinance on 4th April 1992.

The regulatory powers of the SEBI were increased through the Securities Laws (Amendment) Ordinance of January 1995, which was subsequently replaced by an Act of Parliament. SEBI is under the overall control of the Ministry of Finance. Its Head Office is at Mumbai (formerly Bombay). It has since become a very important constituent of the financial regulatory framework in India.

SEBI's governing board comprises of the Chairman, two members from the ministries of the central government dealing with finance and law, two professional members with experience or special knowledge of securities market, and one member from the RBI. All members, except the RBI member, are appointed by GOI. Their terms of office, tenure, and conditions of service is also laid down by GOI. It can also remove any member from office under certain circumstances.
GOI is empowered to supersede the SEBI in any of the following cases:

- If it is deemed to be expedient in public interest
- If SEBI's board is unable to discharge its functions or duties
- If it persistently defaults in complying with any direction issued by the government
- If its financial position and administration deteriorates.

M&A offers tremendous opportunities for companies to grow and add value to shareholders' wealth. M&A is a strategy for growth and expansion. M&A increases value and efficiency and thereby increase shareholder's value. M&A is a generic term used to mean many different types of corporate restructuring exercises.

SEBI - The Regulator

This section tries to point out that in a capital market where regulation is at an evolutionary stage, it is inevitable that actual events prove an important input to improve upon the regulatory framework.

Hence it is imperative for the long-term development of the takeover market to make it obligatory for the acquirers to set out future plans for the target company and how the acquirers propose to implement such plans. The shareholders will be able to evaluate the whether the new management can add value or not.

Clarity required: SEBI should come out with guidelines, which clearly and explicitly mention the statutory approvals, which have
to be mandatory obtained under different laws as well as regulatory bodies. Also all the provisions for escrow should be provided and the offer document should not only contain information about financial resources including details about regarding the sources of funds - from banks, financial institutions or from any foreign source.  

**TAKEOVERS**

A takeover may be generally understood to mean the acquisition of a certain number of shares of an existing company, which enables the acquirer to exercise control over the affairs of the company. In a takeover, an offer is made to the holders of securities carrying such rights, to acquire their securities for a consideration.

The primary purpose of such an offer could be for seeking management control of the company or consolidate existing control over such company. The acquisition of shares may take place in differing circumstances based on which takeovers can be classified as 'Friendly', 'Hostile' or 'Bailout' takeovers.

In Friendly takeovers, acquisition of shares takes place with the approval and agreement of the existing management usually through negotiations. When a person, a corporate entity or a group of persons acting in concert acquire shares for the open market or by negotiations without the company, then such a takeover can be termed as a Hostile takeover. A bailout takeover involves taking over of some potentially sick company in which large amounts of institutional funds are locked up and substantial
public interest is involved. Generally a change in the management in such a company is perceived to help bring about revival of the unit.

Ordinarily, a takeover means acquisition and both the terms are used interchangeably. The company which proposes to acquire another Company is known variously as a predator, offeror, corporate raider etc. The company which is being acquired is known as an offeree, acquiree, target etc.

TAKEOVER TACTICS AND DEFENCE STRATEGIES

Takeover tactics are as follows:
1. Secret accumulation

Purchase sizeable stakes through open market operations, using the services of arbitrages and finance firms. Don’t lodge the shares immediately to preserve the secrecy around the buyer’s identity. Gather up to 10% of the stock before showing your hand so that the open offer for additional shares is made from a position of strength.

Make private bids to small, but corporate, shareholders alongside the open offer to ensure acceptance, and secure their support. Aware of the stock being amassed, but unable to prove officially that a predator is at work, the target company will open itself to negotiations. Then, at the negotiating table, leverage for the best possible deal.
2. **Two tier bid**

Stagger the bid over two stages, **start** with cash offers for over 50% of the stock held by each shareholder of the target company. **Offer to buy the rest at far lower price.** Shareholders in such a situation would prefer to sell. In case the response is not suitable, a revised offer could be made by adding some extra benefits, which would increase the gains for the sellers.

3. **Conditional bids**

Accompany the open offer for shares with an offer to the target company to arrive at a negotiated settlement, perhaps at a higher price per share than that made in the open offer. The option of exit through a conditional bid as well as leeway for making a revised bid at a different price would ensure that you are not locked into your original offer if your conditions are not met and threaten the target.

4. **Asset buyouts**

Instead of bidding for the target company make an offer to acquire its most valuable assets i.e. either the plant or the machinery, or the distribution network or the brand, which will fulfill the acquirers strategic objective. The benefits include simple valuation, easy availability of finance and quick completion of the transaction.
5. **Dawn Raid**

Where brokers swoop down on the stock exchanges at the time of their opening and buy up all available shares swiftly, before the prey reacts.

6. **Bear Hug**

This involves sending the target company’s management a tender offer for its shareholders at an attractive price and warning them to act in the interest of the shareholders.

7. **Saturday night special**

This is a tender offer made over the weekend, giving management 7-10 days to respond. This subsequently came to be known as ‘Godfather offer‘ i.e. an offer that cannot be refused.⁶

**SALIENT FEATURES OF SEBI’s TAKEOVER REGULATIONS**

- Acquirer holding more than 5% of the shares in a company must disclose its shareholding to the company and all stock exchanges where the scrip is listed.

- In a negotiated takeover, acquirer cannot acquire more than 10% shares in a company unless it makes a public offer for another 20% of shares.
• The 20% minimum mandatory offer allowed to be lowered, but conditional on a level of acceptance, provided 50% of consideration payable under the public offer is deposited in an escrow account.

• Creeping acquisition of 2% per year in case of holding not less than 10% and up to 51%.

• Consolidation of holdings above 51% triggers public offer.

• Change in control triggers public offer. The term control defined as the right to appoint majority of directors /right to control the management or policy decisions.

• Minimum offer price to be the highest of
  a) Negotiated price
  b) Highest price paid by the acquirer, for any acquisitions in the last 26 weeks.
  c) Price in preferential allotment of shares to the acquirer in the last 12 months.
  c) Average of weekly high and low of the closing prices of shares in the last 26 weeks.

• Competitive bids allowed within 21 days of the public announcement of first offer.
Takeover Candidates

An ideal takeover target is characterised by some of the following features:

♦ Cash flow in excess of debt service
♦ Committed and competent management team
♦ Moderate growth rate
♦ Undervalued and saleable non-operating assets
♦ Large “off the balance sheet“ assets
♦ An efficient, modern asset base which is not single purpose equipment
♦ Products and processes that are not subject to replacement due to technological changes
♦ Limited “off the balance sheet“ liabilities
♦ Low level of holding by present management /controlling group.

If a large number of these characteristics are present, the candidate would be in serious contention for a takeover. Takeovers do not threaten profitable companies unless such companies are being run to the detriment of the capital market economics or shareholder’s interests. Simultaneously, by taking over either sick companies or companies operating below their optimum capabilities, takeovers actively promote capital formation, through prevention of capital dissipation or net accretion. Hence takeovers are also in the national interest.36
The new take over game will have the following advantages over the previous code:

- Competitive bids are defined
- Condition offers are allowed
- Change in control is now the trigger for offer as opposed to outside purview in the previous case.
- Escrow account is to be 10% as compared to nil in the previous case.
- Consolidations of holdings are allowed.
- Forfeiture of escrow amount is to be the penalty of default. This was not specified in the 1994 code.
- Norms of disclosure have been clearly specified.

Drawbacks in the new takeover code:

- Lack of definition in changes in control will create ambiguity
- Escrow account is not big enough to ward off frivolous takeover threats
- Minimum bid norm denies exit option to shareholders
- Preferential allotments are exempt from the new code’s purview
- Conditional bidders will be stuck with 20% stakes even if bids fail.
STRATEGIES FOR TAKEOVERS

How to identifying a target

- Look for companies whose the promoters stake is less than 20% short list those where two groups each hold 10% or less.

- Search for state government owned units where its holdings are not more than 26% and rest is widely held.

- Locate companies with high growth potential short list firm with larger assets. Low capital bases with fully depreciated assets or with large tracts of real estate or securities.

- Match the ownership criteria with the performance criteria to home in on the ideal target.

Mounting a Primary Market Raid

- Select a company that is promoted bay a technocrat or an entrepreneurs. In most cases they will have modest cash resources. Make an estimate of the degree of over subscription by consulting a primary market broker.

- On time basis, apply for an amount of share large enough to ensure that allotment matches, or exceeds the promoters' stake.

- Purchase more shares after the scrip is listed on the bourses to corner a sizable holding.

Mounting a Secondary Market Raid

- Do not buy shares from the market make offers to the financial institutions and mutual funds through brokers.
• Track down foreign institutional investors non-resident Indians, and foreign shareholders. Offer them a 10% premium on the market price for their holdings.

• After cornering shares, make offers, under the guise of a portfolio manager to other large Indian shareholders.

• Ensure that adorer’s news about target's prospects gets publicity.

• Start stock market purchases on all bourses where the scrip is listed.

Defensive strategies for Raider

Tender offer: Open offer to all shareholders to buy their stakes. Made after bidder has already picked up an equity stake.

Street sweep: Accounting large amounts of stock in a company before making an open offer. Target is left with no choice but to give in.

Bear hug: Pressurizing management of target company by threatening to make an open offer. The board capitulates straight away.

Marketing Sweep: Soften resistance by luring away suppliers and infrastructure support Target Company is forced to give in.

Strategic Alliance: Disarm opposition by offering a partnership rather than a buyout assets control from within and takeover target.

Brand Power: Bring powerful brands into an alliance. Displace partner’s brands and buy out the weakened company.
Defensive strategies for the target

Poison Pill: Low price preferential issue to shareholders to enlarge capital base. Makers hostile take over too expensive.

Poison Put: Bonds that encourage holders to cash in at high prices. Resultant cash-drainage makes target unattractive.

Green mail: Repurchase of the shares cornered by the raider. The profits made by the raider are after all, akin to blackmail.

Pac-man Defense: a counter bid for the raider's company forced is defend himself, the predator must call off his raids.

White knight: An appeal to a friendly company to buy all or part of the company. Buyer promises not dislodge management.

White squire: A sell out of shares to a company, which is not interested in a takeover. Former owners retain contract.

Gray Knight: This is a variation of white knight strategy. The target company, which is under the take over threat, induces cash rich allay to purchase the shares of the predator. The attempt hare is to divert the attention of the predator so that instead of trying to buy the target company's shares, the predator will focus his attention defending his own company.

Shark Repellent: Companies under a take over treat, amend the memorandum of Association or activities of association and/or other regulation so as to make a takeover bid complex and costly thereby discouraging it.
Blank check: The board of directors of the target company authorizes the issue of new shares in order to vote down a hostile take over attempt.\textsuperscript{10}

ACQUIRING CONTROL OF A COMPANY

Generally, an acquirer company can follow two techniques to acquire control of another company the two techniques are as follows:

a. Takeover bid
b. Tender offer

a) Takeover Bid

In a takeover bid, the acquirer company acquires shares of another company to gain its effective control through voting rights. In the case of a friendly acquisition proposal, the acquirer company makes a private confidential approach to the target company.

The approach may be directed to the chairman of the target company, or any one of its directors or investment banker. Typically, the potential acquirer may not have made any recent acquisition of the target company's equity as such an act could be viewed as unfriendly. Also, the potential acquirer could offer to withdraw the bid, once the target company shows its displeasure at such a proposal.
Such a friendly takeover bid is often made for the following advantages:

1. The potential acquirer will be given access to material non-public information about the company.
2. The potential acquirer will have the opportunity to meet and possibly negotiate employment contracts with key employees of the target company.
3. The potential acquirer will be in a better position to negotiate a favorable agreement especially with respect to provisions that discourage competing bid for the target company.

A takeover bid made in a hostile manner lacks such niceties. In such a case the potential acquirer actually purchases shares of the target company without the approval / knowledge of the target company's Board of Directors advantages:

1. Though most of the management are against any takeover proposal the shareholders of the respective companies may be receptive to the proposal.
2. If the potential acquirer has accumulated a substantial portion of equity before launching the hostile bid, it is likely to benefit financially even if outbid by any other competitors.

b) Tender Offer

The acquirer pursues takeover by making a tender offer directly to the shareholders of the target company to sell / tender their
shares. The tender offer, generally, is made without the consent of the acquiree company and is made for cash. The offer price is usually more than the market price and the shareholders of the tender offer is open for a limited period of time within which the shares must be tendered by the holders.

When Tata Tea made a tender offer at a price substantially higher than the market price, more than 50 per cent of the shareholders of Consolidated Coffee Ltd. offered to sell their shareholdings to Tata. Readers may recall that Tata Tea successfully acquired Consolidated Coffee Ltd., with the objective of emerging as a leader in plantation.

The Securities and Exchange Commission, USA generally relied upon an eight-factor test in determining whether a proposed acquisition constitutes a tender offer. These factors are:

1. The active and widespread solicitation is made for shares of an issuer.
2. The solicitation is made for a substantial percentage of the issuer’s stock.
3. The offer to purchase is made at a premium over the prevailing market price.
4. The terms of the offer are firm rather than negotiable.
5. The offer is contingent on the tender of a fixed minimum number of shares and often subject to a ceiling of a fixed number of shares to be purchased.
6. The offer is open for only a limited period of time.
7. The offeree are subject to pressure to sell their stock and
8. Public announcements of an acquisition program precede or accompany the accumulation of stock.

Tender offers as a means of acquiring a public company are useful to the extent they circumvent uncooperative management or preempt competing offeror. Tender offers essentially lack the benefit of negotiation and hence the protection to a purchaser normally built into a contract.\textsuperscript{18}

Bulk acquisitions of shares and takeovers are presently regulated by Clauses 40-A and 40-B and by SEBI (Substantial acquisition of shares and Takeovers) Regulation, 1997, promulgated on 20th February ‘1997.

**How the new takeover code evolved:**

**Traditional provisions** Clause 40 of the listing agreement provides for making public offer by any person who acquires 25% of the voting rights.

1990 The government in consultation with SEBI amended clause 40 of the listing agreement. Threshold acquisition level is reduced to 10% from 25%, change in management control to trigger public offer, minimum mandatory public offer of 20%, disclosure requirement through mandatory public announcement. The amendment provided greater protection to the investors But it had several deficiencies. For one, it had a limited applicability as it could be effectively enforced only if the acquirer was a listed
company. Second, the penalty for non-compliance was the same as that for all other violations of the listing agreement i.e. de-listing of the company shares, which was in fact, detrimental to the interest of the investors.

Nov '94 SEBI (Substantial Acquisition of shares and takeover) Regulations, 1994, notified; new provisions introduced to enable both negotiated and open market acquisitions, competitive bids allowed.

Aug'96 the committee set up under the chairmanship of P N Bhagwati (former chief Justice of India), to examine areas of deficiencies and suggest amendments in 1994 regulations submitted a draft report. The committee which had a wide representation including chambers of commerce, investor's associations, merchant bankers, stock exchanges, legal experts and SEBI, gave new suggestions for amendment in the existing regulations.12

IMPLICATIONS OF TAKEOVER CODE – 97

- For a vast majority of companies it implies a nightmare scenario, where management's and promoters will have to consult their shareholders, to see if predators are burking to strike at the first opportunity.

- For a large community of shareholders and institutions investors, that provides the first real opportunity for their share values to be taken to realistic level or the one
hand, and the opportunity to throw out bad management on the other.

- It will provide the trigger for some radical changes that are due in the corporate sector whereby the shareholders will be able to realize the true value of an investment.

- Takeovers and cross border mergers will open new opportunities for companies to regroup their scarce resources for effecting wealth creation.

- We are in the shareholder of redefining the hand grown corporate practices to suit the global business practices. The process of transparent acquisition is Trust one of them and it will act us a catalyst in integrating the economy with the global market.

- The New takeover code will change the way management's of Indian companies have dealt with their shareholders. Hopefully, the threat of someone else stepping in and taking charge will coerce Indian promoters into looking after their investors better and treat their investments in the company with greater respect.

- Many a promoter feels that shareholders money in their company was as good as theirs, with no cost and no obligation. The promoters spent millions on their junkets and moved around in expensive imported cars, their companies went to dogs and the ultimate loser were the shareholders who were left with worthless pieces of paper.
• The takeover code can change all that. A promoter who spends more time looking after, his pets than his company will find that some body else will elbow him out either to encash his assets or utilize them for their true economic value. Incompetent and dishonest promoters will find it difficult to fight off genuine entrepreneurs in the new corporate regime. And in the process shareholders will be beneficiaries. Henceforth share prices will become the true index of a company performance and value. And when ever a promoter would err in performance there will be many waiting in the wings to throw him out.

• Shareholders in some of the old companies with large assets but poor management’s will be the biggest gainers of the code. Take for example the companies of the erstwhile DCM group companies like DCM Shriram Industries SIEL limited and DCM limited were once the top draws in the country’s capital markets. Poor economic conditions, static product profiles, poor financial leveraging, etc. These have together wiped out the built up prestige of the companies stock. Companies like these continue to hold very large fixed assets in terms of land, buildings capital equipment and commercial space across the country. With low promoters stakes, these companies have given very poor returns to their investors over the past years. Yet for a takeover artist these could offer an impressive opportunity for making gains.
Even if the acquirers make such purchases for the objective of asset stripping it will be in the interest of the companies shareholders. For in this manner at least they will receive some part of the intrinsic value that their investments have built up over the years.

It is ironic that most promoters purchase luxurious farms, office premises and fleet of cars from company’s money yet the shareholder does not get any return on his investment. Even the promoter gets to enjoy the benefit of the assets and not the shareholders. Therefore, in my view SEBI should encourage acquisitions with the express purpose of assets stripping and liquidation. This way the small shareholders will receive some justice.

Asset stripping should not evoke misgivings among public as it does not mean that the asset will be rendered unproductive if it is stripped. It only means that the asset will change hands from one owner to another and most probably the new owner would want to use it even more efficiently to derive returns for the higher price that he paid for it. Asset stripping may, therefore, only enhance the productive of assets and make sure that more efficient hands own an asset.

Introduction of the chain principle in the takeover code also raises interesting possibilities. While it prevents superstitious attempts at circumventing the code, in case of holding companies of some promoters the existing management’s are protected against unholy raiders who may try to take advantage of low prices in one company.
to target others. Once again small shareholders in subsidiary companies would be protected as a result.

- The limit of 2 per cent buying put on creeping acquisitions is also a welcome step as it would henceforth present management’s from hiking their stakes in the companies at the cost of the shareholders.

- In the days to come it will be important to identify stocks that are not only under priced in terms of their earnings but also in terms of their asset valuation. Thus replacement cost calculation may finally make a comeback. All these naturally add up to an exciting opportunity for investors. But it will important that financial institutions and regulatory authorities play a positive role in facilitating the practicality of the system otherwise, like many other well intentioned legislation’s, it may remain a paper only.  

CONCLUSIONS

SEBI’s effort to crack down on insider trading is commendable. Given the rampant insider trading that goes in Indian markets; it is time the regulator stepped in. Most developed countries already have strict laws on the subject. But even as SEBI tries to emulate their example; it need to bear in mind that it has a tough act to follow.

The M & A activities involve large amount of financial resources and the methods an instrument for raising such massive funds need to be identified. So the corporate should
develop proper defense mechanism against hostile takeover bids and make them truly competitive.

Regulatory authorities on their part should curb insider trading and excessive speculative activities relating mergers and acquisitions.

In the next chapter, a detailed discussion of M & A has been made through two case studies.

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