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LIST OF ABBREVIATIONS

IPO - Initial Public Offering
LLP - Limited Liability Partnership
M&A - Mergers and Acquisitions
MCA - Ministry of Corporate Affairs
NCLT - National Company Law Tribunal
NSE - National Stock Exchange
NSEL - NCDEX Spot Exchange Ltd NYMEX New York Mercantile Exchange
OTC - Over the Counter
PCAOB - Public Company Accounting Oversight Board
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CHAPTER 1: INTRODUCTION

1.1. INTRODUCTION

Financial and capital markets play a key role in the funding of high growth companies. For the same companies will eventually have to float their shares on a stock exchange to get access to capital to expand the operation, enhance the company’s reputation, attract and retain talented employees and provide liquidity to shareholders. This is popularly known as Offering.

The offering can be of two types: Primary and Secondary. In primary offering, new shares are sold and sale happens with the objective of raising capital for the company, whereas in secondary offering, the owners of the company sell their existing shares and sale happens with the objective of raising money for the individuals. There is also a mixed offering when the company decides to go public with both primary and secondary offerings. These offerings results in creation of a public company, which is a turning, point in the life of a company.

One of the significant features of the Public companies is that they have thousands of shareholders and are subject to strict rules and regulations. They are also required to have a board of directors and must submit their financial information (Audit and accounting statement) every quarter as per the law. In the United States, public companies report to the Securities and Exchange Commission (SEC). In other countries, public companies are overseen by governing bodies similar to the SEC, like SEBI in India and China Securities Regulatory Commission (CSRC) in China. From an investor's standpoint, the most significant thing about a public company is that the stock is traded in an open market, like any other commodity. Therefore investment is just a matter of cash and choice.

The decision to go public is of vital importance in the life cycle of a company also. There are many reasons as to why a company decides to go public, like external finance or reduction in the debt etc. Also being public brings benefits to a company in reducing its overall cost of capital and makes it more solid in terms of financial dealings with outsiders especially with banks.
However, the main reason a company deciding to go public is to raise money, as being public help companies to raise large capital which is otherwise not possible with a private company, also the risk of ownership is shared amongst a large group of shareholders. In this way spreading the risk of ownership becomes more important when a company’s growth is consistently high and the original shareholders are wanting to cash in some of their profits while still retaining a percentage of the company. One of the biggest advantages for a company to be public is to have their stock listed on a stock exchange.

There is an extant fiancé literature analyzing the decision by companies going public for the first time. The majority of this literature has focused on the most common going public mechanism: The initial public offering (IPOs) of the common stock of the companies, which is the traditional path to listing in an equity market. To go public and offer stock in an initial public offering is a milestone point in the life of privately owned companies. During this option firms hire an underwriter to advice, distribute securities and take principal positions in order to conduct an IPO and issue securities to the public for the first time. In the course of these activities, information is produced. Issuers pay a commission or gross spread and receive the net proceeds when issuing securities. Apart from these costs (direct costs) the issuers have to bear some indirect costs, namely underpricing and the time and input required from the issue’s executives. The IPO process is not only expensive but time consuming, involving an extensive consultation and regulation mandated registration process. These costly and lengthy regulatory requirements, together with sluggish IPO markets and their unavailability to smaller firms, have long been reasons for private companies and their shareholders to look for alternatives to IPOs. This raises the question as to whether there is any alternative available for traditional IPOs and also whether such alternatives are as efficient as IPOs. Such alternatives include Reverse Mergers, Self filing, SPACS etc. A popular alternative is to pursue a backdoor listing, most often accomplished through a Reverse Merger or Reverse Takeover. Both alternatives ‘transform’ a private company into a publicly traded company by combining directly or indirectly with a listed company (whether through a merger, exchange offer or otherwise). A backdoor listing has not

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2 In this study, the terms ‘backdoor listing’, ‘Reverse Merger’, and ‘Reverse Takeover’ are often used interchangeably. Backdoor listings, Reverse Mergers and Reverse Takeovers are viewed as alternatives to an IPO. However, it is recognized that there are technical legal differences in the implementation of each of the alternatives.
only allowed companies to focus more on their business and less on compliance with ‘going public’ rules and regulations, but also to gain access to more liquid and robust (often foreign) stock markets. In addition to the cheaper and quicker access to capital and liquidity, backdoor listings have also been employed to receive tax benefits that stem from tax-loss carry-forwards in the public shell. If the backdoor listing involves a public company that operates in the same or complementary industry or sector as the private company, synergies are often the reason for the backdoor listings. Moreover, besides the fact that a private company becomes instantly ‘listed’ on a stock exchange, a backdoor listing (often a Reverse Merger) usually gives the shareholders of the private company the opportunity to receive the majority of the shares of the public entity, allowing them a tight grip on control (as if they still run a private company)\(^3\).

1.1.1. How does a Reverse Merger work?\(^4\)

A Reverse Merger (hereinafter “RM”) is a non-traditional method of going public. Instead of hiring an underwriter to market and sell the company’s shares in an initial public offering (“IPO”), a private operating company works with a “shell promoter” to locate a suitable non-operating or shell public company. The private operating company then merges with the shell company (or a newly-formed subsidiary of the shell company). In the merger, the operating company shareholders are issued a majority stake in the shell company in exchange for their operating company shares. Post-merger, the shell company contains the assets and liabilities of the operating company and is controlled by the former operating company shareholders. The shell company’s name is changed to the name of the operating company, its directors and officers are replaced by the directors and officers of the operating company and its shares continue to trade on whichever stock market they were trading prior to the merger. Hence, the operating company’s business is still controlled by the same group of shareholders and managed by the same directors and officers, but it is now contained within a public company. In effect, the


operating company has succeeded to the shell company’s public status and is therefore now public.\textsuperscript{5}

**Chart 1. Reverse Mergers: Alternative to going public**

In comparison, an IPO, which is usually managed by an underwriter, some of the firm’s shares are sold in a public offering to new stockholders. After an IPO the old stockholders usually still own a majority of the shares. In a Reverse Merger, a private firm goes public by exchanging its stock for stock in a public firm. After a Reverse Merger, there are new stockholders, but the private firm’s old stockholders own the majority of stock in the surviving firm. In most mergers the bidding firm initiates the acquisition of a target firm and the current shareholders of the bidder become the majority stockholders in the combined firm. In a Reverse Merger the inverse is true: the target firm’s stockholders receive a majority of the stock in the merged public firm. In this sense, the target firm is the surviving firm, and indeed, the name of the bidding firm is often changed to that of the target. If the target firm is private, its shares are exchanged for public

shares of the merged firm and the previous shareholders in the private firm now own the majority of the public stock. In a Reverse Merger with a private target, the public firm that is merged into is often a non-operating entity or shell with few assets.⁶

1.2. PROBLEM STATEMENT

Reverse Mergers are often not excessively burdened by complex listing rules and regulations. They are also equally susceptible to fraud and abuse. This raises a question as to whether special rules and regulations should be introduced by the policy makers and the regulators governing backdoor listings. This question becomes more significant when there is a dramatic increase in the popularity of Reverse Mergers (U.S., China). It is difficult to provide an easy answer. What is remarkable in this respect is to see whether Reverse Mergers can be a sustainable alternative to the ‘front door’ IPO. The answer to the same has resulted in acceptance of Reverse Mergers in U.S. in the form of special rules and regulations. But the same has to be tested in non-US context.

However, in Indian context RM meant completely different. Reverse Merger came to prominence during times of boom when many ventures wanted to cash in their short term success in the form of money. In India, Reverse Merger had different meaning because of a loss carry-over provision under 72A the Income Tax Act 1961 and was predominantly drawn as a scheme of reconstruction under SICA 1985, where a healthy company was absorbed by a sick company to gain the benefits of Section 72 of the IT Act. Interestingly, post -2000 Reverse Merger became more popular, in the form of a scheme, where a promoting company merged with its own subsidiary and these schemes were sanctioned under Sections 391-394 of the erstwhile Companies Act, 1956. However, there existed no comprehensive law regulating Reverse Merger under erstwhile Companies Act, 1956. This resulted in legal acceptance of such transactions as there were no regulatory norms prescribed. But surprisingly Section 373 (2) (h) new Companies Act, 2013 deals with Reverse Merger subject to condition that after the merger the unlisted company shall continue to remain unlisted unless it becomes listed. This raises a concern as to whether Sec 373 (2) (h) of the Indian Companies Act, 2013 results in de-facto prohibition of Reverse Mergers in India? Or whether Indian law has become redundant in

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regulating Reverse Merger? These questions become paramount, as the impact of the new law is that, there is no possibility of a 'backdoor listings' through Reverse Mergers in India.

In the light of above developments, the current research tests a number of IPO theories against the use of Reverse Mergers both at National and International context. Based on the same the research will further examine the feasibility and implications of Reverse Merger regulations in Indian capital market and therefore studying Reverse Merger under Comparative Corporate Law is a must.

It seems odd that the present literature available on the subject of Mergers and Acquisitions has almost ignored the phenomenon of Reverse Mergers. In spite of the fact that Reverse Mergers have become so popular and legal within short span of time, there are virtually no academic studies that deal with the Reverse Mergers. There are many grey areas which are not addressed so far by many regulatory systems.

In the above context, this research will seek to explore some of the issues that have arisen around RMs, identify red flags that may indicate the existence of such issues and discusses initiatives that can be taken to mitigate the risks of their occurrence. This gives the scope for the researcher to study the existing mechanism on Reverse Mergers and the “Law that ought to be” in this area

1.3. LITERATURE REVIEW

1.3.1. Frame of Literature:

During the extensive research all through the scholarship, it is found that, there is a limited research done on the phenomenon of Reverse Mergers. With the rise in popularity of Reverse Mergers, there has been a surprising dearth of academic research except couple of papers analyzing these deals in detail, especially in India. No attempt has been made to study this trend in Indian context despite of new law in place. Basic theories on Mergers and Acquisition are also helpful in forming the basis for this study. The frame of literature contains different dimensions which are needed to lay the foundation of this study. They are divided in three parts. The first part of review emphasizes on general theories of Mergers and Acquisition. The second part will explain “Going Public”, the decision to go public or stay private. This will help one to
understand and link together this part with the last part. The third and last section of the review focuses on theories explaining Reverse Mergers and its relationship with IPOs.

This study compares and contrasts the decision to go public using RMs versus IPOs. The RMs & IPO methods are chosen for comparison because of the small size of the firms involved and because these are the two preferred alternatives available to the private firm.

1.3.1.1. Mergers and Acquisitions

Gallet\(^7\) examined the relationship between mergers and the market power. Rau and Vermaelen\(^8\) investigated the controversial issue of underperformance after mergers and over performance after tender offers through examining the effect of firm size and low book-to-market value on the post- acquisition performance it was done to pinpoint reasons behind underperformance in mergers and over-performance in tender offers if any. Choi and Russell\(^9\) investigated mergers and acquisitions in terms of method of payment, acquisition timing and transaction size.

Choi and Russell investigated whether mergers and acquisitions in the construction sector in U.S. make positive contributions to the performance and determined the factors that may affect post-mergers and acquisitions performance as: method of payment, acquisition timing and transaction size.

1.3.1.2. Going Public

In order to understand the means of going public and determine their feasibility it is very essential to deliberate upon the motives for going public. In this context, few studies are worth citing. In this line, Ritter and Welsh\(^{10}\) have examined the real motives behind companies to gain public listing. According to them, important motives are: to raise equity capital and to create a public market and liquidity for the stock of company, which can allow the promoters cash on

\(^7\) Gallet, C. A. “Mergers And Market Power In The U.S. Steel Industry” APPLIED ECONOMICS LETTERS 3, Page No. 221-223.(1996).
their shares at a future date. Thus they conclude that financial motives are the main driving force for any company while deciding to go public.

While examining the motives behind becoming public, Maksimovic and Pegaret\textsuperscript{11} are of the opinion that, going public is a strategy to add value to the firm. They believe that, trading of shares on public market will gain trust of investors, creditors and customers. In addition going public process will also work out to be an exit strategy for the promoters and venture capitalist. Zingales \textsuperscript{12} puts it from the point of strategic plan as a public company can be sold for a higher value than the private one in case of future acquisitions or takeovers. Brau et al\textsuperscript{13} have also pointed out the same reasons but emphasizing on method of IPO to go public. Pagano et al. \textsuperscript{14} have also analyzed the going public concern in terms of IPOs. According to their study, becoming public provides an opportunity for companies to attain huge and cheap capital by listing at stock exchanges. In the same parlance Ljungqvist (1995) have also made their observations as to The Clustering of IPO and found the possibilities and conditions of the market while opting for IPO.

Thus, there is sufficient literature deliberating upon the motives behind firms to choose to be public. But Majority of this literature has focused on IPO as most common mechanism of going public and the literature on method of Reverse Merger is been negligible. In contrast the academic literature on IPOs is extensive and stock price behavior around IPOs is well documented.

1.3.1.3. The Reverse Merger Process

When the global market started to witness the innovative trend called Revere Merger or Cold IPOs and began to acknowledge the process as it gained more popularity in U.S.A, (Feldmen, 2010) defined "Reverse Merger" as process allowing private firm to acquire a publicly traded firm to obtain their exchange listing. For all practical purposes his study is limited to U.S.

\textsuperscript{12} Novaes, Walter and Luigi Zingales, Capital structure choice when managers are in control: Entrenchment versus efficiency, NBER working paper number 538, (1995).
\textsuperscript{14} Id.,
jurisdiction, more thoroughly examining the SEC filings, reporting and avoiding pitfalls. He has also given an in depth comparative analysis between both RM and IPOs from the process perspective. His findings are the significant benchmarks on which this research builds its arguments. David Feldman’s book (2009) describes the Reverse Merger process in-depth and explains why it is a viable option for small firms. Much of the material in the section of U.S., is taken from this book. Surprisingly, this is one of the only books written on the subject and although it is aimed at an American audience it is nevertheless relevant even to understand and analyze the global phenomenon.

Despite the increased popularity of Reverse Mergers, there have been few studies in the literature. The following review represents all the RM research found to date. Feasibility of Reverse Mergers as an alternative method of going public is one of the primary focuses of this study. The popular academic discussions on Reverse Mergers are Feldman (2006), Paul Asquith (2011), Ioannis V. Floros and Kuldeep Shastri, Håkan Fältmars et al. (2007 ), J Econ Finan (2008).

The study of Pavkov (2006) has been of a great relevance in studying the history and evolution of Reverse Mergers, which helps in understanding the market acceptability and its reaction towards Reverse Merger. Dan Givoly et al (2012) add into this. During the survey of literature, few important papers were found in the academic finance literature on RMs. William K. Sjostrom (2001) has examined the causative factors behind Reverse Mergers and gone to the extent of analyzing its effect on shareholders. Gleason, Rosenthal and Wiggins (2005) have examined 121 RMs listed on the Securities Data Corporation (SDC) Mergers and Acquisitions database. They found that the public firms involved in the RMs are generally poor performers prior to the merger. The RM announcements are associated with significant gains to the stocks of these companies. Based on this result, they conclude that RMs may provide shareholders of distressed firms a way to recover some of their investment. They find no improvement in operations or profitability and only 46% of the companies survive after two years. They also examined that the most commonly cited reasons for RM transactions are cost, access to capital and also analyze the factors such as size, characteristics of the firm, chances of completing the process etc.
Having borrowed the above mentioned basis from Gleason’s study, the literature seconds too many reasons for firms to go public using RM, such as cheaper cost (Feldmen, 2010). This cost factor is studied in comparison to the available alternatives like traditional IPO and penny stock (Gleason, 2005; Floros, 2009). Further, the factors like the non-involvement investment bank and underwriter fees, makes the entire process more simplified and firm friendly (Gleason, 2006; Feldmen, 2010). In addition, Sjostrom (2008) presents the less burden of regulatory compliance as another reason for choosing alternatives to IPO and the same is concurred by (Floros, 2010).

1.3.1.4. Basis for Comparative Study between IPOs and RMs.

RM and IPOs exhibit similar characteristics such as size, profitability, and shareholding. This study has estimated the effect of regulatory requirements on the value and the long-run performance of the newly listed companies. Hence, this study enables an analysis of the effects of RMs Versus IPOs. The analysis of backdoor listing effects is of interest in several countries where RMs are becoming common. Such RMs generally uses cash shells, including the Special Purpose Acquisition Corporations (SPACs). Therefore, the present study has detailed the shell RM and their characteristics by analyzing RMs involving public operating companies as well as public shell companies. It is found that RM companies are highly information asymmetric, since they do not conduct any offering at the consummation of the deal. In the light of the same certain issues of underpricing, information asymmetry, Market reaction, cash out, forward strategies etc. are also deliberated upon.

Brown, Dittmar and Servaes (2005) have examined the firms using roll up and IPO method. Their analysis are based on the pre roll-up and post-roll up stocks. In comparison of alternative paths to going public, Brau, Francis and Kohers (2003) compare the choice of conducting an IPO to RM. According to them, firms in highly concentrated markets, with more assets, higher insider ownership, lower leverage, lower liquidity, and in time periods with higher 3-month T-Bill rates choose the IPO path. In contrast, private companies in high market-to-book industries, financial service sectors, highly leveraged industries, and deals involving greater liquidity for selling

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15 Roll-ups are transactions in which a shell company goes public while simultaneously merging with a number of other firms that operate in the same industry.
insiders show a stronger likelihood for takeovers. Their findings also indicate that a liquidity discount exists in takeovers relative to IPOs.

In an another comparative study, Poulsen and Stegemoller (2008) compare outright-sellouts to IPOs and find that when firms have greater insider ownership prior to the transaction, higher growth, more investments and more R&D expenditures then they prefer to do an IPO. Similar to Brau, Francis, and Kohers (2003) by examining the motives for roll outs, found that firms with greater levels of information asymmetry are more likely to choose a sellout than an IPO. Hogan, Olson and Kish (2001) compare Reverse Leveraged Buyouts (RLBOs) to IPOs and found that the average initial returns of RLBO firms are consistently lower than those of IPO firms. While examining the same, they have identified the factors affecting the pricing of firms such as: information asymmetry and the reputation of the underwriter, lockup periods, the size of the stock exchange, and the duration the RLBO firm remained private.

Gleason, Jain and Rosenthal (2006) have compared the traditional IPOs, RMs, and self-underwritten IPOs. According to them, the firms which opt for RM and self-underwritten IPO are smaller and of lower profitability. Their study has found that, these companies opting for RM and self written IPO outperform their matched traditional IPO companies in the short run, but exhibit comparable performance three years following the going public decision.

Adjei, Cyree and Walker (2007) study provides an empirical basis for this comparison. Any doctrinal study will not be validated unless it takes in to account the findings of the empirical one too. Therefore the present study has based its theoretical arguments on the findings of these especial studies. Adjei, Cyree and Walker (2007) have studied the phenomenon delisting of firms in both IPO and RM methods. They found that, 42 percent of RMs compared with 27 percent of IPOs are delisted within three years of listing on an exchange. They also show that RM firms do not comply with any listing requirements, whereas IPO firms do comply with at least one requirement of the listing exchange.

Sjostrom (2008) presents a very interesting finding. Like any other study mentioned above, he describes the RM method of going public by analyzing the RMs’ deal structure and legal compliance and argues that RMs are not really comparable to traditional IPOs as they are smaller. However his study has limited application since size is not only the bench mark for the
analysis presented in this dissertation. Though size is one of the significant factors, many factors have been identified in the present study, which serve as bench mark for comparison between IPOs and RMs. Therefore, Sjostrom findings have limited application and relevance to the present study.

Arellano Ostoa and Brusco (2002) provide a theoretical model. They identified specific conditions in which high quality firms opted IPOs and low quality firms for Reverse Mergers. According to this study, these low quality firms are also not very likely to raise capital after completion of the Reverse Merger. But there are studies which have provided solutions as to overcome this, which Ostoa and Brusco does not address.

In a comparison of RMs with penny stocks IPOs, Floros and Shastri (2009) found that RTO firms are smaller, have lower profitability and lower liquidity in comparison to IPO. They point out that, strategic acquisitions using the publicly traded stock as the mode of payment is the major factor in determining the RTO method. On the other hand, however, Gleason et. al. (2006), present that RTOs outperform their matched traditional IPOs in the short term and generally exhibit comparable performance in the three years following their public listing, more specifically SPACs.

Hogan, Olson and Kish (2001) compare Reverse Leveraged Buyouts (RLBOs) to IPOs and found that the average initial returns of RLBO firms are consistently lower than those of IPO firms. The main factors that affect the information asymmetry and consequently the pricing of these companies are the reputation of the underwriter, the existence of lockup periods, the size of the stock exchange, and the duration the RLBO firm remained private. Floros and Sapp (2009) study shell RMs and report three-month abnormal returns of 48.1% to shell shareholders surrounding the consummation of a deal. They found that, shell companies have no systematic risk, operations, or assets, and their returns tend to decline over time. They conclude that, this exceptional return is compensation for shell stock illiquidity and the uncertainty of finding an RM suitor. In addition to the academic literature on alternative mechanisms to go public, the recent literature on PIPEs Sabino (Rod) Rodriguez III (2005) supports the analytical framework.

Motivated by the recent debate on Chinese Reverse Mergers (CRMs) in US, Jindra et.al. (2012) examine the cost and characteristics of CRMs in comparison to Chinese firms that had Ordinary
cross-IPO listings in US exchanges. According to this study, cost is the driving force behind bringing firm over U.S. stock exchanges. They also present that, CRM firms are smaller in terms of assets and less profitable than those listed through an IPO. They indeed find that CRMs are substantially smaller in terms of assets but have higher leverage.

Carpentier et. al. (2012) has presented a different study and approach from those cited above. They have examined the implications of regulatory framework and found that the choice of the listing method and regulation strictness have a positive impact on the long-run performance of newly listed firms. This study was limited to Canada. In addition to this, Ignatyeva et. al. (2012) also provides some evidence on the potential implications of the regulatory and structural framework. But this study was done with specific reference to European SPACs (Special Purpose Acquisition Vehicle). According to them, European SPACs are more flexible and able to complete their acquisitions more quickly due to less restrictive regulation at the European stock exchanges.

While studying the market condition and its reaction towards firms, In contrast to IPOs that are more likely under “hot” market and industry conditions (Brau et. al. 2003), Semenenko (2011) concludes that public distressed firms are generally used as vehicles to go public by the private firms when market conditions are unfavorable. On the other hand, private firms take control over public firms in good financial health during period of favorable market conditions. Derrien and Kecskes (2007) report similar patterns. While analyzing the IPO waves, they report that, good flexibility is available to RTOs and this serves as additional strategic benefit in relation to IPO.

Anna Faelten, Naaguesh Appadu and Mario Levis, do not agree with the findings of Sjostrom (2008) on RTOs being cheaper. They argue that this conception is misleading and depends on the deal complexity and market conditions. Backing the same Barron's, among others, imply the RM process allows less reputable firms to go public (Alpert, 2010). In contrast, Sjostrom (2008) and industry experts argue the new SEC regulations with related scrutiny have enhanced the credibility of RMs.
1.3.1.5. The contradictions identified among the major literature

Gleason, Rosenthal, and Wiggins (2005) have examined 121 RMs of public companies listed on the NYSE and NASDAQ-AMEX between 1987 and 2001. They found that the RMs are poor performers. They conclude RMs are a high risk choice for going public. Gleason, Jain, and Rosenthal (2006) compare RMs to traditional and self underwritten IPOs. They studied 119 RM transactions between companies listed on the major stock exchanges between 1986 and 2002. They found RMs and self-underwritten IPO companies overall are smaller with lower profitability and outperform traditional IPO's over the first few months. However, in their longer run analysis of three years, all the groups have similar performance track records. Adjei, Cyree and Walker (2008) studied 286 RMs and 2,860 IPOs from 1990 through 2002, and found 42% of RMs and 27% of IPOs are delisted within three years of going public. They concluded that RMs exhibit lower profitability and survival rates compared to IPOs. Sjostrom (2008) documents the RM process, legal structure and compliance requirements. He argues RMs are smaller on average and thus, generally cannot be compared to traditional IPOs. Carpentier and Suret (2008) found Canadian companies that go public using RMs have generally poor performance after going public. Carpentier, Cumming, and Suret (2009) compare going public with Canadian RMs and IPOs and found the choice of a reputable auditor adds value in issuing IPOs, which have a higher level of disclosure.

Floras and Shastri (2010) studied the decision to go public comparing RMs between U.S. based private and public firms listed on U.S. stock exchanges versus penny stock IPOs. They argue firms involved with RMs are information asymmetric as very little stock is issued to the public. Floras and Sapp (2010) studied 585 trading shell companies from 2006 - 2008 that are trying to consummate a RM agreement with a private company based in the U.S. They found a significant percentage of RMs consummated with public shell companies organized specifically to transact RMs with promising private firms. Their results show average successful transactions experience returns of 48.1% over the first 3 months and are more profitable than that of Special Purpose Acquisition Companies (SPACs).
1.3.1.6. Popular studies on Reverse Mergers:

Table 1 presents a brief summary on RM studies, most of which have been mentioned earlier. Amongst the many available studies, only few major studies are selected based on the variety of issues they have addressed. This summary makes it easier when analyzing differences between both.

Table 1: Summary of popular studies

<table>
<thead>
<tr>
<th>Author</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>David Feldman (2010, USA)</td>
<td>Definition of Reverse Merger</td>
</tr>
<tr>
<td>Gleason, K.C., Rosenthal, L. &amp; Wiggins, R.A. (2005)</td>
<td>Small, young companies typically undertake RMs. Short term some gains can be seen but long term they usually fail to generate any wealth for shareholders. 46% have not survived two years. Still, they conclude it is an important mechanism, albeit a risky one for investors.</td>
</tr>
<tr>
<td>Carpentier, C., Cumming, D. &amp; Suret, J-M. (Canada)</td>
<td>High listing requirements decreases information asymmetry and significantly affects long term performance positively. Mostly low quality firms choose the RM route. They conclude IPOs are better due to more regulations but find that in Canada they performed similarly.</td>
</tr>
<tr>
<td>Adjei, F., Cyree, K.B. &amp; Walker, M.M. (USA)</td>
<td>Small, young companies with weak performance are typical for RMs. 42% of the companies delisted in the three year period study.</td>
</tr>
</tbody>
</table>
LoSardo, M.J. & Zhu, J.  
“A Further exploration of Reverse Mergers as an alternative to IPOs”  
(USA)  
Find that RMs did better than the American index. Find that good performance is correlated with trading activity. See RMs as positive.

Brown, P., Ferguson A. & Lam, P.  
“Choice between alternative routes to go public: backdoor listing vs IPO”  
(Australia)  
Poor long term performance for RMs, even short term gains are small and underpricing is often present. The RM route is not always an easier and quicker way to go and appears to not always be chosen by small companies.

Roosenboom, P. & Schramade, W.  
“Reverse Mergers in the United Kingdom: listed targets and private acquirers”  
(UK)  
Long-run performance similar independent of listing route. Short-run target returns are positive and the bigger the private acquiring company relative to the public target is, the larger the abnormal returns are.

Brown, Dittmar & Servaces (2005)  
Brau, Francis, & Kohers (203)  
Hogan, Olson and Kish (2001)  
Adjei, Cyree & Walker (2007)  
Arellano Ostoa & Brusco (2002)  
Flotas and Shastri (2010)  
Comparisons between Reverse Merges and IPOs

1.3.1.7. Summary

The above discussed previous studies have focused on RMs between companies that are already operating and listed on a U.S. or the Canadian stock exchange and basing their comparisons and findings on one single or few factors. Through the survey it was found that, no attempt has been made to test, compare and draw the similarities and contradictions keeping all the factors in place as bench marks. The present study makes an attempt to compile all these factors discussed disruptly through out and examines the feasibility of both the options in the capital market. Further as the above review has shown that, in the past no study has focused on the option of Reverse Mergers in India and Its feasibility in the Indian capital markets. Therefore this study
makes an attempt to examine the justification of prohibiting Reverse Merger under Indian Companies Act, 2013 and feasibility of legalizing the same. Furthermore, Indian context shall be studied in the context of comparative corporate law with special reference to U.S. and China Jurisdictions analyzing various cases of Reverse Merger. As far as China is concerned, this will be the first attempt to draw parlances between two highly competitive jurisdictions.

1.4. SIGNIFICANCE AND UTILITY OF THE RESEARCH

Capital Markets works as a backbone of country’s economy. It is one of the most important factors in boosting of a country’s economy. Thus it is not wise to neglect areas of Reverse Merger which is been opted by many private companies as backdoor entry to get into the Capital Market listing. The research shall be useful, because of the following reasons.

➢ In India regulators have caused de-facto prohibition on easy access to the Capital Market via Reverse Merger, which calls for an immediate attention towards its. Therefore in this research; by contrast, the researcher approaches this issue by comparing IPO and Reverse Merger in a non-US context (India, China) where the Regulatory standards for listing are flexible and growth specific. This non US approach will be beneficial and added knowledge to the literature available on Reverser Merger in developing countries like China and India.

➢ Legalizing and permitting Reverse Merger should be re examined in Indian and International Context as the cost and regulatory scrutiny of being a Public Company in today’s post-Enron environment must be balanced against the benefits of accessing broader ranges of capital for any company seeking monetary postures. This issue is of utmost significance in addressing and countering future problems in Capital Markets across the globe.

➢ Across the Asian Capital markets especially in China the Reverse Merger method is starting to get well known. Many popular companies have gone public through Reverse Merger method and very limited studies have been made so far. In India, there has been a discussion about the regulations and consequences since the ICICI deal, but the new Companies Act, 2013 has disallowed the use of this technique without addressing and highlighting the fundamental factors behind the transaction. This provision can be quite
burdensome especially for a growth company seeking to access capital within a specific time period. In the absence of academic studies on Reverse Mergers in India and the fact that Indian Law imposing a de-facto prohibition on the use of this technique provides a valid ground to examine and analyze the feasibility of Reverse Mergers in Indian context.

Since there is a lack of academic as well as industrial research in India, there is a need to identify and appreciate the ground experiences and realities, valid grounds and facts for substantiating the need for recognizing the Reverse Merger as a legitimate way of going Public. Hence, the researcher realized the need to study and analyze the various factual issues - social, economic, political- cultural and legal - that are to be examined so as to identify not only legal reasons but also with economical and financial reasons for finding feasibility of Reverse Mergers in Indian Capital Market. Therefore the researcher hereby proposes to demonstrate the need for having a re-look at Reverse Merger in India in the interest of the economy.

Hence, the researcher proposes to adopt the exploratory, descriptive and comparative studies, which will help the researcher in presenting the information in a logical, coherent and systematic manner in the researcher’s own way, is by itself a contribution to the existing knowledge. It also points out the disparities in the present Indian Law and proposes some suggestions to overcome the same.

Thus, with the increased popularity and questions about the legality of Reverse Mergers, legislators, regulators, corporate executives and financial analysts should find the results of this study relevant useful.

1.5. OBJECTIVES OF THE RESEARCH

This research is directed towards testing the economic desirability of Reverse Merger in Indian Capital Market, evaluating the potential for a more harmonized and coordinated mechanism for legalizing and regulating them in India. In particular, it is directed towards the following objectives:

➢ To define, compare and trace Reverse Merger with IPO in order to draw the latest implications and feasibility of both in the capital markets.
To explore and provide a theoretical framework with criteria or benchmarks in comparative corporate law to analyze various cases of Reverse Merger in US, China and India.

To reexamine the potential of allowing Reverse Merger in India under the New Companies Act, 2013 in the light of causative factors, risks and remedies.

1.6. RESEARCH QUESTIONS

1. What is the history and evolution of Reverse Merger and its differentiation showing how various global developments have influenced this process?

2. How Reverse Merger has been similar or contrasting with IPO and what are its latest implications and feasibility in the capital markets?

3. What are the risks associated with Reverse Merger transactions and how do they affect the interests of the stakeholders concerned and ways to mitigate them?

4. What is the basic regulatory framework available with criteria or benchmarks, in comparative corporate law to analyze the feasibility of Reverse Merger in US, and China and what are the possible legal issues and remedies present within such frameworks?

5. Are Reverse Merger regulated in India? What is the impact of Indian Companies Act, 2013 in that regard? And whether the recent Indian regulatory approach is on par with latest international developments? What should be the right approach for India in this regard?

1.7. SCOPE AND LIMITATIONS OF THE RESEARCH

The scope of the present research is limited to study the feasibility of Reverse Mergers in India and compare the same with that of the traditional IPO method with selective literature from India and Globe. And it further limits its scope to study and critically examine the Legal framework for regulating Reverse Mergers in India, U.S., and China more specific to Hong Kong.
1.8. METHODS ADOPTED

The method of study is doctrinal coupled with qualitative data analysis, which helps in validating the doctrinal findings. During its doctrinal course the study will take note of the latest developments and trends in the field of study through different literary sources available.

1.8.1. Theory Selection

Fundamental theories adopted to analyze the data include theories on Mergers and Acquisitions, IPOs and Reverse Merger. However, on the subject of Reverse Merger, the theory base is limited.

Majority of the theories examine the underlying motives behind Reverse Mergers focusing more on trends and factors in US capital markets. The same lay the foundations for the present research because there has not been any extensive research of this subject in India. The theories which are analyzed in this report are collected through SLS, Pune and NLSIU Library and through legal databases mainly from Jstore, Ebsco, SSRN and West Law data basis..

1.8.2. Descriptive and Exploratory Study

This approach has helped the researcher in finding out what has happened? It involves ascertainment of state of affairs in respect of the issues and the research questions rose above. Further the researcher has ascertained and described the attitude of the Regulatory authorities of the Capital market in application of the law and regulation of the capital market itself. In this regard the nature of the jurisdiction, powers, functions, and mode of working of regulatory authorities are described in detail with the suggesting reforms.

1.8.3. Analytical and Critical Studies

The present research has focused on analysis of the facts and the information available on the issues and research questions raised above. This approach has involved an examination of rules, principles, cases, concepts and theories of Reverse Mergers. This study is predominantly concerned with the law reform. Capital markets face new challenges everyday and law is confronted with new problems (problems are discussed as part of issues). The existing Law in India on Reverse Mergers is inadequate and also inappropriate to deal with such problems.
Therefore the purpose of this study is to analyze and examine the nature, purpose and adequacy of Law in this area and then has suggested ways in which changes may be introduced and also it further evaluated the extent to which changes may succeed to achieve the desired results. Besides it has critically evaluated the current legal framework available to regulate Reverse Mergers in USA, China, Hong Kong and India.

1.8.4. Historical Study

The research has also involved the study of history and evolution of Reverse Merger, its related facts, events and the regulations concerned. Further it has also helped in demonstrating its differentiation showing how various policies, legislations and bi/multilateral agreements in the past have influenced this process.

This approach has enabled the researcher to understand the historical developments of Law and Regulations in Reverse Merger in order to assess the utility and adequacy of the Law as it exists now and the need for reform. Since the present legal provisions in US, China and India have raised meaningful questions, this historical approach is necessary to explore the circumstances in which the present situation came about.

For this study, the researcher has relied on public and private documents, legislative debates, files, the past newspapers, circulars, articles, manuscripts, books, tape recordings, legal and economic materials throwing light of the issues concerned.

1.8.5. Comparative Study

Since the variations between the characteristic of newly listed firms is limited without a left tail of low quality issuers, analyzing the effect of listing and disclosure requirements is in the U.S., Context. Recent studies of the effects of regulation on the cost of capital use cross-national comparisons or regulatory changes in foreign countries. Therefore, the present research, by contrast has approached the issue by comparing IPOs and RMs in a non-US context where the regulatory standards for listing are extremely low.
Further, this approach has enabled the researcher to examine as to what are the similarities and dissimilarities between Reverse Merger and IPO and how does they supplement and contrast each other in order to find out its latest implications and feasibility in the capital markets.

This approach has also helped the researcher in presenting the information existing in three different factual contests i.e., US., China (more specifically with Hong Kong) and India in order to examine the merits and demerits in a comparative perspective and also to compare and contrast views, ideas, values, concepts, rules, principles, theories and conditions of the capital markets that has become bearing on the law and the institutions concerned. The purpose of this approach is to bring about improvements in Law, so that it may work more effectively and efficaciously.

1.8.6. Method of study

For the purpose of this study, research combines both qualitative and quantitative data. Opinions of the financial experts and relevant academicians provide an insight into the feasibility of Reverse Mergers in India. While a statistical analysis can identify the demand and requirements of the stakeholders. By combining both qualitative and quantitative method, the present study can recognize and describe how, why and what factors of the research.

1.8.7. Case Study Method

As a part of qualitative technique the researcher has adopted the case study method for the purpose of studying and analyzing the complex factors in a given issue (Here the Companies chosen for the study). With the help of this, effort is made to know the mutual inter-relationship of causal factors behind IPO’s and Reverse Mergers and success and survival of companies who opted for Reverse Merger.

Sources for gathering the data under case method

Collected the documents related to the deal that has taken place, which has provided the information about the events, situations and vast knowledge about the nature of the phenomenon.
1.8.8. Research Approach

The researcher has combined both deductive and inductive methods, since it is the most suitable approach for the purpose of this research “Not only is it perfectly possible to combine deduction and induction within the same piece of research, but also it is often advantageous to do so.”\(^{16}\)

The deductive approach provides data for or against a theory. The inductive approach provides information to develop new hypothesis or theory\(^ {17}\). An inductive approach helps in arriving at understanding of the nature of the problem and analyzing the data to create new theory. The outline has a deductive perspective, were a theoretical framework is defined and then used in the analysis. However, this is a relatively new research topic in India with little existing literature, which makes the work more inductive with an aim of generating and analyzing new data. By adopting both approaches in the current research, an objective outcome is aimed at.\(^ {18}\)

1.8.9. Data Collection

This research is based on both primary data and secondary. The primary data is collected through both a qualitative and quantitative methods to arrive at the most precise answers to the research questions raised. The same data shall be gathered through, interviews, surveys and other types of methods that gather knowledge. Due to the fact that there has been very little research done in India it is hard to find both primary and secondary data providing a complete picture. The data will therefore be collected through samples, case studies and secondary sources and a statistical analysis designed to fully meet the purpose of the research. The research questions have been the foundation for determining the shape of the primary data.

**Sample selection:**

The qualitative data in this research has been collected through questionnaires from financial advisors with knowledge of Mergers and Acquisitions. The selected group is inclusive of representatives from the corporate section of highly respected firms, which have been directly or indirectly involved in Mergers and Acquisition deals. Since in India the Reverse Merger deals


\(^{18}\) Saunders et al, supra note 4.
have been very few, most of the M&A experts have not personally come across the Reverse Merger transactions in hand. Hence, their opinions are based on their experience with general Mergers and Acquisitions transactions and capital market requirements. In addition to it, opinions from the academicians have also been gathered as their theoretical experience adds value to the in hand experiences of the market experts. All these opinions are analyzed and written into summary at the end of the thesis.

The participants received the questions by e-mail. Few participants did answer to questions over the phone and the same was noted. Even if the questionnaire was of a general guide approach with focus on collecting the same information from each interviewee, it still allowed a degree of freedom and adaptability in gathering the valuable information from the participants.

1.8.10. Tools Used

The present study has been carried out with the help of different books written by Indian and foreign authors, legal and economic journals on Mergers and Acquisitions national as well as international. For carrying out this study different web resources were used including legal data bases such as Lexisnexis, Westlaw, Heinonline, Wilson etc. Further the journals written by professors of different universities and different resource persons such as research scholars on the relevant issue are also referred.

Unfortunately, no known database service tracks Reverse Mergers, Leaving policy database regulators and practitioners largely overshadowed by uncertainty as to the merits of the transaction. Only new data base such as Lexis nexus and Westlaw would be of great source of information as no single periodical reports each transaction. Accordingly, salient information regarding Reverse Merger in Indian trend is not known, namely information on frequency, deal size, deal consideration, post-transaction stock performance, stock trading patterns, incidence of subsequent bankruptcy, incidence of insider trading, incidence of securities fraud, incidence of securities class action suits, age of private company vent causing public company to become shell, average number of employees and executive compensation form and amount. Therefore the secondary data will be of significant help.
1.9. RULES OF CITATION

The researcher has followed the Blue Book (19th edition) Rules of Citation in the present research.

1.10. SCHEME OF CHAPTERIZATION

In chapter one, the researcher introduces the topic and reviews the literature pertaining to going public including both IPOs and Reverse Mergers, wherein the research makes an attempt to find out and explain the gaps in the academic literature. In chapter two, the researcher traces the history and evolution of the Reverse Mergers. On basis of the gaps found in the literature survey during the first chapter, the research analysis the similarities and the differences between IPOs and Reverse Mergers in third chapter. The risks associated with Reverse Merger transactions and the remedies available to tackle such risks are discussed under chapter four. Chapter five extends the analysis shown in chapter three and further extends it to jurisdictions like U.S.A, China and more specifically to Hong Kong and the possible issues; its impact and their remedies are also discussed here. Next, chapter six deals specifically with India, where the feasibility of regulating Reverse Merger in India is examined in the light of International developments. Chapter seven has incorporates the empirical findings, concluding remarks, reflections and scope for further research.