Chapter-VI
Hostile Takeovers : Emerging Trends

Introduction

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

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

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

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

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

HOSTILE TAKEOVER: A BRIEF CONCEPTUAL EXPLANATION

A takeover takes place when one company acquires control of another company, usually a smaller company than the first company. It may be defined as a transaction or series of transactions whereby a person (individual, group of individuals or a company) acquires control over the assets of another company, either directly by becoming the owner of those assets or indirectly by obtaining the control of the management of the company.\(^1\) The company, which acquires control of another company, is called the ‘acquirer’ (offeror) whereas the company, which is acquired, is called the ‘target’ (offeree). In a case where shares are closely held (i.e. held by a small number of persons) a takeover will generally be effected by agreement with the holders of the majority of the share capital of the company being acquired. Where the shares are held by the public generally, the takeover may be effected:\(^2\)

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

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

3. By means of a “takeover bid”.

A takeover bid is a technique for affecting a takeover or a merger\(^3\): in the case of a takeover, the bid is frequently against the wishes of the management of the target company; in the case of a merger, the bid is generally by consent of the management of both companies. It may be defined as an offer to acquire shares of a company whose shares are not closely held (dispersed shareholding), addressed to the general public.


\(^2\) Id.

\(^3\) The distinction between a ‘takeover’ and a ‘merger’ is that in a takeover the direct/indirect control over the assets of the acquired company passes to the acquirer, in a merger the shareholding in the combined company will be spread between the shareholders of the two companies. Often the distinction is a question of degree.
body of shareholders with a view to obtaining at least sufficient shares to give the offeror voting control of the company.

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

**A takeover may broadly be classified into two categories:**

i) **Agreed/Friendly Takeover:** where the Board of Directors of the target agree to the takeover, accept the offer in respect of their own shareholdings (which might range from nil or negligible to controlling stake) and recommend other shareholders to accept the offer. The directors of the target may agree to do so right from the start after early negotiations or even after public opposition to the bid (which may or may not have resulted in an improvement in the terms of the proposed offer); or the directors of the target may actually have approached the offeror to suggest the acquisition. In a friendly takeover, the controlling group sells its controlling shares to another group of its own accord. However, as we shall see later, because of Regulation 12 read with Regulation 3(1) (c) of the SEBI Takeover Regulations, 1997 there is no compulsion to make an open offer in a friendly takeover.

ii) **Defended/Hostile Takeover:** a takeover bid is hostile if the bid is initially rejected by the target Board. It is sometimes also called ‘unsolicited or unwelcome bid’ because it is offered by the acquirer without any solicitation or approach by the target company. In a hostile takeover the directors of the target company decide to oppose the

\(^4\) Recently, the Bhagwati Committee on Takeover has recommended that the acquirer should be permitted to offer shares of the third company as consideration for shares tendered. This is essentially to increase the flexibility available to the acquirer in funding the offer.
acquiring company’s offer, recommend shareholders to reject the offer and take further defensive measures to thwart the bid. The decision to defend may be influenced by a number of factors but more often than not it is with the intention of (a) stopping the takeover (which in turn may be prompted by the genuine belief of the directors that it is in interests of the company to remain independent or by a desire of the directors to protect their own personal positions or interests); or (b) persuading the bidder to improve the terms of its offer.

A hostile takeover primarily involves changing the control of the company against the wishes of the incumbent management and the board of directors. This throws up a lot of social, legal & economic issues this chapter to tries throw light on all those issue.

There may be different motives/causes behind launching a takeover bid and it is not necessary, as widely believed, that only poorly performing firms are the potential targets of a hostile bid. Bidders seem to pursue companies with strong operating managements as often as they pursue companies that have been clearly mismanaged. In fact bidders seldom seem to be interested in a firm where a turnaround is unlikely. For instance, truly sick companies – or at least those whose problems do not appear to be easily remedied – become indigestible and survive, immune from takeover, precisely because of their inefficiency. A bidders offers a premium, often very high, to acquire a target and a rational bidder will offer such a premium over the market price (and incur notoriously high transaction costs as well) only if it believes that the future value of the target’s stock under different management will exceed the price it offered the target’s shareholders within a relatively brief period. There may be a number of objectives behind mounting a hostile bid. It may be a strategic objective like consolidation/expansion of the raider/acquirer. It may be aimed at achieving ‘economies of scale’/critical mass/reducing costs in a particular product/service market. It may also be aimed at acquiring substantial market share or creating a sort of a monopoly.
Following are the primary motive/causes of a takeover

1. **Assets at a Discount**: this refers to a situation where the offeror can acquire the assets/shares of a target at less than the value, which the offeror or its shareholders place upon them: a process commonly referred by financial journalists as” acquiring assets at a discount”. The situations in which assets may be available at a discount are:

   - Where the target has not put its assets to their most efficient use;
   - Where its directors are unaware of the true value of its assets;
   - When it has an inefficient capital structure;
   - Where it has followed a policy of limited distribution of dividends;
   - Where the shares have a poor market rating relative to its real prospects; or
   - Where due to any other non-economic reasons, the shares of the target are trading at low prices.

2. **Earnings at a Discount**: because the offeror can by taking over the target acquire the right to its earnings at a lower multiple than the market places on the offeror’s own profits, a process that can be described as acquiring “earnings at a discount”.

3. **Trade Advantage or Synergy**: because there is a trade advantage or an element of synergy (i.e. a favourable effect on overall earnings by cutting costs and increase in revenue) in bringing the two companies under a single control which is believed will result in the combined enterprise producing greater or more earnings per share. This has been found to be one of the
biggest drivers of takeovers in the 1990s. In a globally competitive environment the companies require a critical mass to be able to survive and prosper and the lexicon of even the most hostile endeavours is filled with sober phrases like synergy, the global marketplace and accretion to earnings etc. This can be achieved either through a ‘horizontal takeover’ or a ‘vertical takeover’.

The factors leading to this improvement in earnings could include:

- Economies of scale;
- Ensuring raw materials/ sales;
- Marketing advantages;
- Acquisition of a competitor;
- Diversification or reduction of earnings volatility;
- Purchasing management.

4. **Method of Market Entry:** because it represents an attractive way of the offeror entering a new market on a substantial scale.

5. **Increasing the Capital of the Offeror:** Because the offeror has particular reasons to increase its capital base. These include the acquisition of a company a large proportion of whose assets are liquid or easily realisable instead of making a rights issue and the acquisition of a company with high asset backing by a company whose market capitalisation includes a large amount of goodwill.

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6 Horizontal takeover refers to coming together of two companies producing same, similar or competing products/services.

7 A vertical takeover means coming together of two companies, though engaged in the manufacture or provision of same goods/services but at different points in the supply chain. It includes forward and backward integration.
6. **Management Motives:** Because of motives of the management of one/other of the Companies, either the aggressive desire to build up a business empire or personal remuneration or the defensive desire to make the company bid-proof.

**Takeovers perform following important functions in an economy:**

- Successful takeovers help realise efficiencies by reallocating capital and corporate assets to more high-value uses; enabling two entities to generate joint operating efficiencies and providing companies access to financial, management and other resources not otherwise available. It unlocks the hidden value of unutilised/underutilised assets by transferring them from inefficient management to an efficient management. This function of takeovers is commonly described as the ‘market for corporate control’. The term was coined by Professor Henry Manne in 1965 in his seminal paper on the utility of tender offers and of an active market for corporate control. According to this description, there is a market for the rights to manage corporate

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9 This view, particularly as embellished by later adherents, emphasized the importance of the threat of hostile takeovers as a *management accountability mechanism* and as a central feature of a market-oriented model of corporate activity and corporation law. Manne argued that, since capital markets are efficient sub-optimal managerial performance would be reflected in reduced share prices. Discounted share prices would invite tender offers by those seeking to profit from replacing incumbent management and realizing a corporation's full economic potential. The existence of a vigorous, properly functioning market for corporate control would immediately benefit shareholders by offering the prospect of stock premiums. Moreover, shareholders would gain over the longer term because the threat of takeover would encourage managerial diligence. Furthermore, the bidder's direct financial appeal to target shareholders made the tender offer a much more potent takeover device than the proxy contest, in which shareholders might only dimly perceive how granting a proxy to insurgents would actually improve their economic welfare, and in which management enjoyed inherent legal and collective action advantages owing to its control of the proxy machinery. In addition to citing the wealth and governance benefits of takeovers to capital providers, Manne touted the purported benefits of takeovers to society in general. He argued that an effectively functioning market for corporate control rechannels corporate assets into the hands of those most able and willing to maximize their value. The result would be a more efficient use of limited economic resources, by which everyone -- not merely shareholders -- would benefit. For the purposes of further discussion we may term Manne's theory as ‘Disciplinary Hypothesis’. Cf. Lyman Johnson and David Millon, “Misreading The Williams Act”, 87 *Mich. L. Rev.* 1862, 1878 (1989).


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resources in just the way that there is a market for different kinds of goods and services. Companies are up for auction for those who wish to take control from the existing owners. If bidders attach a higher value to control than the existing owners, then they should be allowed to purchase it. The market in corporate control ensures that companies pass to those who attach highest value to ownership. Michael Jenson and Richard Ruback, vocal supporters of hostile bids wrote in 1983: “The market for corporate control is creating large benefits for the shareholders and for the economy as a whole by loosening control over vast amounts of resources and enabling them move more quickly to their highest-valued use. This is a healthy market in operation … and it is playing an important role in helping the American economy adjust to major changes in competition and regulation of the past decade. They allow companies to realize the benefit of large-scale operations or to achieve what is called ‘economies of scale’.

- It is widely believed that hostile takeovers help in policing the management conduct in widely held public corporations. It has a disciplining effect on the incumbent management as the threat of a hostile takeover keeps them on their toes to perform efficiently and deliver goods to the shareholders.\(^1\)

- Moreover, they help identify undervalued assets and permit shareholders to realise the true value of their investments.

Hostile takeover threat can trigger far-reaching changes in corporate strategy resulting in significant gains to the shareholders. Many have claimed that without a hostile takeover the inertia that exists within many large organizations would have prevented such efficiency-enhancing (and consequently, shareholder value enhancing) restructurings from taking place.

\(^{11}\) This view received a qualified endorsement in Edgar v. MITE Corp., 457 US 624, 643 (1982).
According to Weinberg and Blank a takeover may be achieved in the following ways:

- Acquisition of shares or undertaking of one company by another for cash.
- Acquisition of shares or undertaking of one company by another in exchange of shares or other securities in the acquired company.
- Acquisition of shares or undertaking of one company by a new company in exchange for its shares or other securities.
- By acquisition of minority held shares of a subsidiary by the parent.
- Management buyouts.

The concept of takeover without consent termed as “Hostile Takeover” No consented the history of hostile takeover. Can be traced to 1980 with U.S. Supreme Court for the first time sat in judgment over the anti–takeover provisions of the Illinois Business Takeover Act & pronounced them as invalid in landmark ruling in Edger vs. MITE Corp. in Indian companies. FII’s must be registered with SEBI and RBI, but his special designation gives them the right to buy and sell Indian securities, realize capital gains from Indian investments, and repatriate any gains made in India, inter alia.\(^\text{12}\) The average FII stake in the BSE 100 exceeds 18%, or roughly nine times the average stake of the once – powerful Indian financial institutions. In contrast to the FI’s, foreign institutional investors, who have fewer links to the old business family elites and take seriously the fiduciary duties they owe their investors to maximize returns, would be expected to vote based purely on economic interest and hence could be expected to vote in favour of a hostile acquisition that offered a significant premium.

III. HISTORY OF HOSTILE TAKEOVER ACTIVITY IN INDIA

The concept of takeover without consent termed as hostile takeover. No consented history of hostile takeover can be traced to 1980s with U.S Supreme Court for the first time sat in judgment over the anti-takeover provisions of the Illinois Business Takeover Act and pronounced them as invalid in landmark ruling in Edgar vs. MITE Corp. Hostile takeovers occur rarely even in the most mature economies, so it then should not be surprising that in India, where the economy was only liberalized in 1991, a mere dozen or so hostile takeovers have been attempted. The four cases illustrated below are meant to provide historical context to the current situation and illustrate some of the political and technical barriers that a foreign hostile acquirer might face today.

Swaraj Paul’s failed bids for escorts and DCM

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

Today, the ability of a target company to refuse to register shares is highly constrained. Following an amendment to the companies Act providing for free transferability of shares, the Indian courts have ruled refusal that to register shares may only be undertaken if the transfer is found to be in violation of law.\textsuperscript{14}

\textbf{Asian paints / ICI}

Nearly 15 years after Swaraj Paul’s failed hostile bids, the Indian government and business community were still not prepared to accept a hostile foreign acquisition. ICI, a paints company headquartered in the U.K., had agreed with Atul Chosky, the managing director and co-founder of the Indian paint company, Asian paints, to purchase his 9.1\% stake.\textsuperscript{15} His three other co-founders, however, opposed his sale to a foreign party, and threatened to refuse to register ICI’s shares in the same fashion as Escorts and DCM. Ultimately, the government of India, through its Foreign Investment Promotion Board, (FIPB) thwarted the bid, ruling that foreign acquirers taking control of an Indian company needed to first obtain board approval.\textsuperscript{16} This was peculiar, given that the remaining co-founders together retained well above ICI’s 9.1\% stake and hence would maintain control over the company. Without the support of the other three founders, however, the deal failed to win board approval, and was ultimately abandoned.\textsuperscript{17}

According to a leading investment banker I interviewed, the FIPB was influenced by significant political lobbying in this situation. As will be discussed in the next section, government approval of most foreign takeovers today only involves enforcement of sectoral FDI limits. Of course, a government keen to block a foreign takeover may find ways outside of the formal regulatory structure to scuttle such a bid.\textsuperscript{18}

\begin{itemize}
  \item[14] Section 111A of the companies Act is the new section allowing for free transferability of shares.
  \item[15] India Rejects ICI Bid for stake in Asian Paints, Ltd., \textit{Asia Pulse}, November 3, 1997.
  \item[16] Id
  \item[17] Id
\end{itemize}
India cements / Raasi cements

The only hostile takeover in Indian history resulting in ultimate acquisition of the target by the hostile bidder occurred in 1998 when BV Raju sold his 32% stake in Raasi cements to India cements.\textsuperscript{19} India Cements made an open offer for Raasi shares, and it acquired roughly 20% on the open market,\textsuperscript{20} but faced resistance from the founders of Raasi as well as the Indian financial institutions which also owned substantial stakes in the firm. However, following a protracted battle which involved press conferences featuring the children and grandchildren of the founding family protesting the hostile bid, Raju ultimately sold out to India cements in a privately negotiated transaction.

Gesco

The Dalmia group’s purchase and sale of its 10% stake in the real estate firm GESCO for an approximately 125% premium in 2000 is the closest India has come to greenmail.\textsuperscript{21} This hostile bid, for 45% of the company, was only averted thanks to a white knight recruited by the founding Sheth family, the Mahindra group, which offered to buy-out the entire remaining float for an even higher premium.\textsuperscript{22} After an intense bidding war that drove the initial offer price up roughly 100%, the Mahindra-Sheth group agreed to buyout the Dalmias’ 10% stake.\textsuperscript{23}

Recent Cases of Hostile Takeover Bids.

Kraftfoods Madea $ 16.3 billion in Nov. 09 for British candy maker Cadbury. In May 2010 Pepsi Company tried to acquire Pepsi America Inc. and recently Roche,

\textsuperscript{19} ICL succeeds in Raasi Cements Takeover, Statesman (Kolkata), April 6, 1998.
\textsuperscript{20} This preceded the current Takeover code, which would have required a mandatory open offer after crossing the 15% threshold.
\textsuperscript{21} Greenmail refers to a tactic that gained notoriety in the U.S. in the 1980s where a raider buys up a significant stake in a target company, threatens to launch a hostile takeover, and then accepts a substantial above-market premium to sell back this stake in a privately negotiated transaction with the company. See generally, Jonathan Macey and Fred McChesney, A Theoretical Analysis of Corporate Greenmail, 95 YALE L.J. 13 (1985).
\textsuperscript{23} Id.
Sams and In Bev tried their hands at takeover as well. In fact, hostile takeover actually make up over 10% of Merger and Acquisition activity in past one year that means vultures are feasting.

**Restriction imposed on Hostile Takeovers**

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

DEFENCES TO HOSTILE TAKEOVERS

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

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

On the other hand, companies in other EU countries are not so shareholder-centric. Shareholders are clearly one interest group, but many others exist: workers, the existing management, suppliers, providers of finance other than shareholders (like banks and financial institutions), and other related companies. Such groups are often referred to as stakeholders in a company – those who are involved in the day-to-day operations and who in most EU countries have a right to play a part in the process of running and controlling the company. Of course, in a country like India where an active market for corporate control is still to develop, the question of corporate accountability either to shareholders or to other stakeholders has hardly received any significance worth mentioning. In the pre-liberalisation era, India’s giant industrial houses, most of them family-controlled, enjoyed the government-conferred monopoly status upon them and they hardly bothered to increase shareholder value.
Equally guilty have been Indian banks and financial institutions, which held substantial stake in large public companies but they largely remained passive onlookers and never questioned management/board’s decision even if the decision went against their own interests as a shareholder in the company. Post-liberalisation era, due to increasing competition from foreign and some new aggressive domestic players, has brought about some welcome changes in the area of corporate accountability. A healthy return to shareholders is increasingly being recognised as an important benchmark of corporate success. Therefore, in India it is highly desirable that a healthy market for corporate control is allowed to develop.

**The most commonly adopted defense strategies to hostile bids are:**

1. **Staggered Board**

   This defence involves an amendment of the by-laws of the company to create a staggered board of directors. A staggered board is a board whose members are elected in different years or in other words only part of the board comes up for election each year. Implementation of a staggered board may cause an acquirer to have to wait for several years or at least till the next annual general meeting before it controls the board of directors. Because the acquirer would not control the board initially, the acquirer would not have the power to change management or the corporation's business plan. As with the other pre-tender offer defences, courts will allow amendment of the charter to create a staggered board of directors provided the amendment is allowed under the governing corporation law and the amendment was made for a valid business reason.

2. **Poison Pills.**

   A defensive tactic, which originated in the US and is mainly employed in the US. A poison pill is a shareholder rights plan that encourages a would-be acquiring company to talk to target’s directors before seeking to acquire more than a certain

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percentage of the target’s stock, because not doing so will result in substantial
economic harm to the acquirer as the rights held by it will become void, and all other
shareholders will be able to buy shares of the target at half price.\textsuperscript{25} A rights plan can
be adopted without shareholder approval and the directors authorize the rights to be
distributed as a dividend to target’s shareholders. These rights can be redeemed by
the Board of Directors or exercised. If they are exercised, the resultant
preferred stock might be convertible into ordinary shares at an extremely attractive
price – essentially raising the cost of the bid. Such pills are referred to as ‘flip-
overs’. Alternatively, the rights might be purchased by the issuing firm at a large
premium over the issue price, with the large shareholder excluded from the
repurchase. These are known as ‘flip-ins’.

3. **Buyback of Shares**

   1. Open market repurchases

   2. Self-tenders

Critics of the buyback strategies argue that the discriminatory effects on target
shareholders will defeat value-increasing bids\textsuperscript{26}. Open market purchases tend to
distort shareholder preference and defeat value increasing bids. In a model given by
Bradley and Rozenweig the result of open market purchases is that it amounts to a
special dividend payout to selling shareholders that distorts shareholder choice.\textsuperscript{27}
However self-tenders can be defended on the ground that buyback creates an auction
for the companies’ resources among competing management teams. Proponents

\textsuperscript{25} Mark R. Wingerson and Christopher H. Dorn, 1992. *Columbus, L. Rev.* 223.

\textsuperscript{26} Jeffrey N. Gordon and Lewis A. Kornhauser, “Takeover Defence Tactics: A Comment on Two

\textsuperscript{27} The model offered by them is: consider a target firm with 200 shares outstanding, trading at $40 a
share prior to the bid, and thus valued by the market at $8000. The acquirer values the firm at a
minimum of $10000 and makes a two-tier offer, front loaded bid of $60 for the first 100 shares and
$40 for the remaining shares. According to the model prevailing market value of target shares will
increase to reflect the expected value of a tendered share, $50. Target management then defends with
an open market repurchase of 120 shares at $50, which reduces the value of the firm by $6000 as a
result of the outgo. The bid is withdrawn and the value of the firm to $2000, or $ 25 a share. The
bidder will then present a revised offer bid at around $25, substantially below the earlier $50. This
leads to a distortion of the shareholder decision and defeat of a value-increasing bid. Thus the
conclusion that the remaining shareholders will have financed the premium received by the lucky
open market sellers.
argue that they tend to defeat value-decreasing offers and not value increasing ones. The critics however argue that if the target finances the self-tender through the sale of special synergy assets the bidder may simply withdraw its bid. Self-tender is not like an auction process. Target management is spending the shareholders’ money and not its own funds.

4. Crown Jewels

These are precious assets of the target often termed as Crown Jewels, which attract the raider to bid for the company’s control. On facing a hostile bid the company sells these assets at its own initiative leaving the rest of the company intact and hence removes the incentive for which bid was offered. Instead of selling the assets, the company may also lease them or mortgage them so that the attraction of free assets to the predator is suppressed. By selling these jewels the company removes the inducement that may have caused the bid.

5. White Knights

After coming to know of an initial hostile bid other rival bidders also enter the battle often offering higher bids than the initial bidder. Among the rival bidders whose bids are recommended by the target company are classified as ‘white knights’ or this expression is also used to refer to a an acquirer whom the target, faced with a hostile bid, approaches to save it from being taken over by the initial bidder.\(^2\)

6. Golden Parachutes

This defense requires management to arrange employment contracts between the management and key employees to increase their post employment compensation in the event of a hostile takeover. When golden parachutes are created for management and key employees, a corporation becomes less attractive to the acquirer because generous payments to departing management and employees could financially deplete the corporation.

\(^2\) For example, in Renaissance Estates Ltd.’s bid to takeover Gesco, the promoters of Gesco had roped in Mahindra as a ‘white knight’ to save them from being taken over.
7. **Greenmail**

A targeted share repurchase, or greenmail, is the buyback of the shares owned by a particular shareholder of the target who has made or threatened a takeover bid. The greenmail payment is typically at a premium over the prevailing market price. A large block of shares is held by an unfriendly company, which forces the target company to repurchase the stock at a substantial premium to prevent the takeover. The critique of this theory is that the management, which has mismanaged the target’s assets, pays greenmail in order to perpetuate its ability to exploit the targets. According to this view greenmail should be prohibited because it decreases shareholders’ wealth and discriminates unfairly.

8. **Corporate Restructurings**

Asset disposals announcement by the target firm that parts of its existing business will be sold off, e.g., sale of subsidiaries, the disposal of holdings in other companies, sale of specific assets such as land or property, de-merging of completely unrelated businesses, decision to concentrate on core businesses and hiving off non-core interests etc. By doing so the target seeks to make the company less attractive for a potential acquirer.

9. **Legal/Political defenses**

Where the target firms seek the intervention of the regulatory bodies or indulge in political lobbying to repel the hostile bidder. This might be in the form of an appeal to the competition regulatory bodies that the resultant entity would violate the anti-trust norms. But these strategies rarely succeed often resulting in delays and increase in the costs of the bid both to the bidder and the target. However, in countries like India, political/legal interventions can cause considerable delays which can either frustrate the initial bidder leading it to withdraw or costs may increase.

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escalate so much due to delay that the bidder may be forced to withdraw on prudent economic considerations.

10. Joint Holding (or) Joint Voting Agreement

Two or more major shareholders may enter into an agreement for block voting or block sale of shares rather than separate voting. This agreement is entered into with the cooperation and blessings of target Company’s management who likes to have a control.

11. Interlocking shareholdings or Cross Shareholdings

Two or more group companies 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 takeover bids. If the interlocking of shareholdings is accompanied by joint voting agreement then the joint system of defense is termed as "Pyramiding", which is the safest device or defense.

12. Defensive Merger

The directors of a threatened company may acquire another company for shares as a defensive measure to forestall the unwelcome takeover bid. For this purpose, they put large block of shares of their own company in the hands of shareholders of friendly company to make their own company least attractive for takeover bid.

13. Pac-Man Strategy

This is nothing but a counter bid. The target company attempts to Takeover the hostile raider. This usually happens when the target company is larger than the predator or is willing to leverage itself by raising funds through the issue of junk bonds.
CONCLUSION

The broad policy question this paper seeks an answer to is whether hostile takeover needs to be restricted or promoted or it should be left untouched with minimum set of regulations. The answer depends upon whether benefits to the society of a hostile takeover outweigh its costs. There are certain advantages and disadvantages of a hostile takeover and it may be difficult to categorise it into a strict mould in order to say that hostile takeover should be promoted or discouraged. It is a widely shared belief that hostile takeovers allow the shareholders of the target company realise the best price of their investment or in other words it promotes economic efficiency by transferring the control of corporate resources from an inefficient management to an efficient one. While it is true that hostile takeovers are value-maximising to the target shareholders; some hostile takeovers may promote efficiency, some may result in a misallocation of economic resources, and some may be neutral in terms of economic efficiency. After all market behaves on the basis of past records and future expectations and therefore, when a company makes a bid for another share price of the target generally rises in anticipation of more profits and greater shareholder returns from the company under the new management. But, there is no guarantee that the new management would not mismanage and hence, if mismanaged, the reallocation of resources may not be promoting efficiency.

Moreover, it is not necessary that only poorly managed companies become takeover targets; even well-managed companies may be the targets of a hostile takeover, this is especially true when the primary purpose of takeover is consolidation, business synergy and to achieve growth in size and volumes. When a well-managed company is acquired by another equally well-managed company, the takeover may be neutral in terms of economic efficiency.

Secondly, the proponents of hostile takeover zealously argue that hostile takeover has a disciplining effect on inefficient managements and therefore, an active market for corporate control is not only desirable but it should be promoted. However, this disciplinary hypothesis – namely, that poor stock market performance implies poor management - also has its limitations. Poor stock prices may be due to a number of
non-economic reasons and something else may be occurring on an industry-wide basis, or on a narrower basis within a portion of that industry, that precludes an inference of managerial failure based solely on below average stock performance. For example, an overproduction in the world steel market coupled with low demand has caused share prices of steel company to fall steeply, however, it does not imply that TESCO is a poorly managed company and hence a potential takeover target.

Further, bidders seem to pursue companies with strong operating managements at least as often as they pursue companies that have been clearly mismanaged and a bidder’s search will be biased in favour of industries in which it already operates. Since firms within the industry have greater knowledge about each other’s properties, products and prospects, this certainty of information enables the bidder to pay a higher premium to emerge as the winning bidder. This may result in the displacement of a competent management of the target after acquisition. In such situations the Disciplinary Effect of hostile takeover has no consequence.

Therefore, it is appropriate to say that the market for corporate control has a disciplinary effect, but the scope of that effect tends to be more limited than neo-classical economic theory has made it out to be.

As a consequence, a public policy toward hostile takeovers that seek to promote them in the interests of economic efficiency and greater shareholder returns may have to contend with the dangers of increased industry consolidation and oligopolistic market.

Now, the question arises whether the conclusion drawn above varies from country to country and can it be something different in case of India?

In the specific Indian context, we have a long history of family run business houses which tend to pay scant regard to improving returns to shareholders and vast economic assets are lying underutilised under their control, it may be desirable to allow a regulated but not restricted market for corporate control to operate in order that old blue-chip companies are run in accordance with sound management principles and the influence of corporate families are reduced on the running and
management of the company. What should be guarded against is the notorious US-style ‘bust-up’ takeovers and the impact of hostile takeovers on non-shareholder constituencies must also be kept in mind.