Directorate of Distance Education
NALSAR University of Law, Hyderabad

Reading Material

Post-Graduate Diploma in Financial Services & Legislations

1.2.5 Mergers Acquisitions & Corporate Restructuring

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Module I: Introduction to Corporate Restructuring

Corporate Restructuring

Corporate restructuring is an action taken by the corporate entity to modify its capital structure or its operations significantly. Generally, corporate restructuring happens when a corporate entity is experiencing significant problems and is in financial jeopardy.

The process of corporate restructuring is considered very important to eliminate all the financial crisis and enhance the company's performance. The management of concerned corporate entity facing the financial crunches hires a financial and legal expert for advisory and assistance in the negotiation and the transaction deals. Usually, the concerned entity may look at debt financing, operations reduction, any portion of the company to interested investors.

In addition to this, the need for a corporate restructuring arises due to the change in the ownership structure of a company. Such change in the ownership structure of the company might be due to the takeover, merger, adverse economic conditions, adverse changes in business such as buyouts, bankruptcy, lack of integration between the divisions, over employed personnel, etc.

Types of Corporate Restructuring

1. **Financial Restructuring**:
   This type of restructuring may take place due to a severe fall in the overall sales because of the adverse economic conditions. Here, the corporate entity may alter its equity pattern, debt-servicing schedule, the equity holdings, and cross-holding pattern. All this is done to sustain the market and the profitability of the company.

2. **Organisational Restructuring**:
   The Organisational Restructuring implies a change in the organisational structure of a company, such as reducing its level of the hierarchy, redesigning the job positions, downsizing the employees, and changing the reporting relationships. This type of restructuring is done to cut down the cost and to pay off the outstanding debt to continue with the business operations in some manner.

Characteristics of Corporate Restructuring

- To improve the Balance Sheet of the company (by disposing of the unprofitable division from its core business)
- Staff reduction (by closing down or selling off the unprofitable portion)
- Changes in corporate management
- Disposing of the underutilised assets, such as brands/patent rights.
- Outsourcing its operations such as technical support and payroll management to a more efficient 3rd party.
- Shifting of operations such as moving of manufacturing operations to lower-cost locations.
- Reorganising functions such as marketing, sales, and distribution.
- Renegotiating labour contracts to reduce overhead.
- Rescheduling or refinancing of debt to minimise the interest payments.

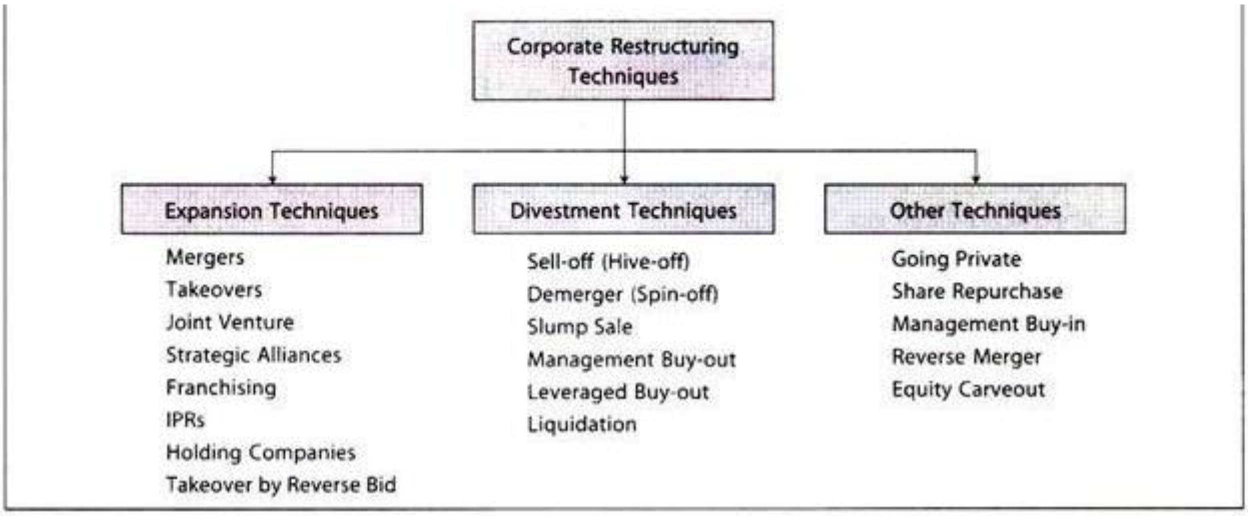
- Conducting a public relations campaign at large to reposition the company with its consumers.

Important Aspects to be considered in Corporate Restructuring Strategies

- Legal and procedural issues
- Accounting aspects
- Human and Cultural synergies
- Valuation and funding
- Taxation and Stamp duty aspects
- Competition aspects etc.

Types of Corporate Restructuring Strategies

The techniques generally adopted in corporate restructuring and reorganization are shown in figure



Technique # 1. Joint Ventures:

All joint ventures are typically characterized by two or more ventures being bound by a contractual arrangement which establishes joint control.

The contractual arrangements establish joint control over the joint venturers.

Such an arrangement ensures that no single venturer is in a position to unilaterally control the activity.

Joint venture may give protective or participating rights to the parties to the venture.

Protective rights merely allow a coventurer to protect its interests in the venture in situation where its interests are likely to be adversely affected.

Joint venture is a form of business combination in which two unaffiliated business firms contribute financial and/or physical assets, as well as personnel, to a new company formed to engage in some economic activity, such as the production or marketing of a product.

Joint venture can be formed between a domestic company and foreign enterprise in order to flow the skills and knowledge both the ways.

Technique # 2. Divestitures:
Divestitures are considered as one of the important techniques in corporate restructuring.

Divestitures does not deal with acquisition or combination but it frequently examine the various recently acquired assets and divisions to determine whether the assets or divisions are fit into overall corporate strategy in value maximization and its future plans.

If it does not serve the purpose, such assets or divisions are hived-off.

Technique # 3. Slump Sale:
When a company sells or disposes the whole or substantially the whole of the undertaking for a predetermined lumpsum amount as sale consideration is called 'slump sale'.

The acquirer may be interested in purchase of an undertaking or part of it as a going concern and the acquirer is not interested in taking the whole company as part of the transaction.

While fixing the selling price, the value of assets are not individually counted and the liabilities are not separately considered while fixing the slump price.

A business transfer agreement will be entered into between the acquirer and seller and the hive-off deal passes the title for both movable and immovable properties and the related liabilities as a 'going concern'.

Technique # 4. Strategic Alliances:
An 'alliance' is defined as associations to further the common interests of the members.

Strategic alliance is an arrangement or agreement under which two or more firms cooperate in order to achieve certain commercial objectives.

The motives behind strategic alliances is to reduce cost, technology sharing, product development, market access, availability of capital, risk sharing etc.

The concept of 'alliance' is gaining importance in infrastructure sectors, more particularly in the areas of power, oil and gas.

The basic objective is to facilitate transfer of technology while implementing large objectives.

The resultant benefits are shared in proportion to the contribution made by each party in achieving the targets.

In strategic alliance, two or more firms that unite to pursue a set of agreed upon goals, remain independent subsequent to the formation of an alliance.

The strategic alliances are generally in the forms like joint venture, franchising, supply agreement, purchase agreement, distribution agreement, marketing agreement, management contract, technical service agreement, licensing of technology/patent/trade mark/design etc.

Technique # 5. Equity Carveout:
It is a situation where a parent company sells portion of its equity in a wholly owned subsidiary to the general public or to a strategic investor.

An equity carveout enable the parent to generate cash inflow which can be used for further investments.

In a spin-off, the shares received from the acquirer of undertaking is distributed among the existing shareholders of the parent company.

But in equity carveout the shares of the parent company are sold out to outside investors.

Technique # 6. Franchising:
Franchising provides an immediate access to business operations and technology in profitable fields of operations.

It is an important means of doing business in several countries and represents an effective combination of the advantages of large business with the motivation and adaptation capabilities of small or medium scale enterprises.

It also enables linkages of large and small businesses within a framework of vertical division of labour.

The concept of franchising is quite comprehensive and covers an extensive range of marketing and distribution arrangements for goods and services.

Franchises are becoming a key mechanism for technological, marketing and service linkages between enterprises within a country as well as globally.

Technique # 7. Intellectual Property Rights:
The worth of a company lies more in its intangible assets (patents, trademarks, brands, copyrights etc.) than tangible assets (land, building, plant & machinery).

The intellectual property rights give real value to a company.

Patents, trademarks and strong brands lead to higher sales, economies of scale and profits.

Some business gains, however, instead of investing efforts, time and money in research and development for new patents, trademarks and brands, prefer to buy these from companies or go to the extent of acquiring the companies themselves.

Technique # 8. Holding Companies:
A holding company enjoys controlling interest in the subsidiary by acquiring substantial voting power in the form of acquisition of equity shares carrying voting rights.
When the holding company acquires 100% voting power in subsidiary, it is called 'wholly owned subsidiary'.

Acquisition of controlling interest in subsidiary by holding company is form of combination and can also be used as a technique of restructuring.

The holding company is also called as ‘parent’ enterprise.

Technique # 9. Sell-Off:
In a strategic planning process, a company can take decision to concentrate on core business activities by selling off the non-core business divisions.

A sell-off is a sale of part of the organization to a third party in the following circumstances:

(i) To come out of shortage of cash and severe liquidity problems.

(ii) To concentrate on core business activities.

(iii) To protect the firm from takeover activities by selling-off the desirable division to the bidder.

(iv) To improve the profitability of the firm by selling-off loss-making divisions.

(v) To increase the efficiency of men, machines and money.

(vi) To facilitate the promising activities with enough funds by sell-off non-performing assets.

(vii) To reduce the business risk by selling-off the high risk activities.

Technique # 10. Going Private:
In a restructure program, the management of the widely held company may decide to go private by purchase of stocks from the outside public and delisting the shares in the stock exchanges where the shares are traded.

By going private, a company can avoid the predators from bidding the company.

It can avoid the listing fees of the stock exchanges and when the company is in financial difficulties this will avoid the fall in share prices.

It facilitates to avoid the declaration of periodical results for general public. By keeping-off from the public, trade secrecy can be maintained.

Technique # 11. Liquidation:
A business may go into decline when losses are made over several years.

The losses are setoff against past profits retained in the business (reserves), but clearly the situation cannot continue for very long.

In such case liquidation of company may be imminent.

In case of technological obsolescence, lack of market for the company's products, financial losses, cash shortages, lack of managerial skills, the owners may decide to liquidate the business to stop further aggravation of losses.

With a strategic motive also, a business unit may be liquidated.

Technique # 12. Takeover by Reverse Bid:
Normally, a large company takeover a small company.

But when a small company acquires a big company, in a takeover mode, such situation is called 'takeover by reverse bid'.

This would be possible when the substantial shares are in the control of small company or its directors.

It would also be possible when the small company is a cash rich company and big company is a sick company.

The takeover by reverse bid enables the acquirer to exploit the economies of scale.

BIFR had also encouraged this mode of takeover for rehabilitation and revival of sick industrial companies.

Technique # 13. Reverse Merger:
In normal practice, it is the larger company which acquire a smaller one.

But in case of reverse merger it is a smaller company acquires the larger company.

The reverse merger may be motivated by tax benefits available whenever at least one of the companies in deal has accumulated loss or unabsorbed expenses/allowance that can be carried forward and set off against future profit of the amalgamated company.

The takeover by the smaller firm would also be more appropriate if it had the better record and more promising future. In some cases the smaller company is listed but the larger company is not and, therefore, in order to keep the listing, without having to pay costs in obtaining a new one, the smaller listed company makes the acquisition.

The restructuring through reverse merger process is carried on following three steps:

(i) Capital reduction of the losing company to write-off the share capital not represented by assets.

(ii) Consolidation of shares after capital reduction to make face value of shares of the acquirer at par with that of the target.

(iii) Change of name after merger to publicize the name of the target.

Technique # 14. Demerger:
Demerger is adopted as a business strategy to separate business which don't comfortably merge with each other.

Two businesses may have different strategies, operational or regulatory needs which are difficult to fulfill while they are still linked.

They may even be competing with each other for business.

A demerger is a form of reorganization where business activities owned by one company or group are separated out into several companies or groups.

Each business will usually have the same ultimate ownership as before.

A demerger may also be a step towards sale to third party.

The demerger refers to a situation, where an undertaking is separated and transferred to a separate company and decided to run into as an independent unit from the earlier enterprise.

The demerger is also called as 'spin-off' or 'hiving off'.

By demerging the business activities, a corporate body splits into two or more corporate bodies with separation of management and accountability.

The strategic reasons resulting for demerger may be as follows:

(i) Restructuring the existing business, by segregating different uncommon activities into different corporate bodies.

(ii) Separation of management of different undertakings.

(iii) Introduction of the concept of responsibility accounting and accountability.

(vi) Protection of business from high risk activities and undertakings which are continuously incurring cash losses.

(v) Bringing clear lines of management.

(vi) Protection of crown jewel from the predator through hostile takeover.

(vii) Avoidance of frequent interference of government and its agencies in business.

(viii) Division of family managed business.

(xi) Tapping more opportunities and counter against threats.

(x) Separation of unwanted activities and to concentrate on core activities.

(xi) Enable management buy-out.

The potential disadvantages of demergers are as follows:

(i) Loss of economies of scale,

(ii) Lower turnover and profitability,

(iii) Increase in overhead,

(iv) Loss of benefits from synergy, and

(v) Loss of ability to raise extra finances.

Technique # 15. Management Buy-In (MBI):
The management team who have got special skills will search out and purchase business, to their interested area, which has considerable potential but that has not been run to its full advantage due to lack of managerial and technical skills, fails to establish the market for the company's products.

After the identification of suitable unit for purchase, the management team will make arrangements with the venture capitalist for finance.

The management team will generally have lesser funds for investment and, therefore, debt component will be more in their purchase of the business unit.

The MBI is just reverse to MBO. In MBI, the management of other concern, not the management of the same company, acquires the majority shareholding and thus the existing management of the concern has to leave the concern.

Technique # 16. Management Buy-Out (MBO):
MBO is the purchase of a business by its management when the existing owners are trying to sell business to third parties due to its slow growth or lack of managerial skills in running the business.

The existing managers will come forward to purchase and run the business by taking it over from the owners.

In a MBO, the managers purchase all or part of the business from its owners.

The management team will take substantial controlling interest from the existing owners who are having control over the affairs of the company.

The management team may consist of one or more directors and employees, either with or without inviting for external associates.

It is a method of setting up of business by the management team itself.

The cases of MBO occurs when the existing owners unable to run the company successfully and when the very existence of the company is at stake.
The MBOs are used in restructuring the business and to tide over the recessionary tendency in business.

Technique # 17. Leveraged Buy-Out (LBO):

An LBO is defined as 'the acquisition of an operating company with the funds derived primarily from debt financing, by a small group of investors'.

In LBO, debt financing typically represents 50% or more of purchase price.

The consideration for LBO is a mix of debt and equity components with high gearing.

The debt is secured by the assets of the acquired firm and is usually amortised over a period of less than ten years.

In a typical LBO program, the acquiring group consists of a small number of persons or organizations sponsored by buy-out specialists or investment bankers.

This group, with the help of certain financial instruments like high-yield, high-risk debt instruments (junk bonds), deferred payment instruments, private placement instruments, bridge financing, loans from venture capitalists, merchant bankers etc., acquire all or nearly all the outstanding shares of the target firm and takes the target firm private.

The buy-out group may or may not include current management of the target firm.

The typical targets for an LBO include any of the following:

(i) If the company does not have share-holdings more than 51%.

(ii) If the company is over leveraging with the debt components nearing to maturity.

(iii) If the company has diversified into unrelated areas and thus facing problems.

(iv) If the company is earning low operating profits due to poor management and there is a possibility of turnaround.

(v) If the company is having an asset structure which is grossly under-utilized.

(vi) If the company's present management is facing managerial incompetence.

Motives behind Restructuring

Successful restructuring and reorganization of an organization require good preparation in advance, good planning which will address all the programmatic needs, support services which are needed to advance those organizational goals, good planning of the workforce and brilliant communication skills.

Organization leaders find it highly important to change how these units operate for a few reasons like changing priorities of units, enhancing the effectiveness of organizations, addressing the budget reductions, initiating new programs etc.

Now we are going to discuss some of the reasons, strategies and benefits of organizational restructuring.

How to Plan Organizational Restructuring Strategies?

There are some tips and ideas that can help you plan organizational restructuring strategies.

1. Give importance to quality over quantity:
It is highly important to lay special emphasis to quality over quantity both in the size of the company as well as the product development. With such profitable websites which are being run by two people, there are thousands of employees that won't help you become powerful. In fact, they will make you exorbitant and expensive and necessitate an output schedule that is ambitious. You should also keep those who are dedicated experts and also ask them to be resourceful as well as accountable and put out that quality of products which any group can easily and confidently promote.

2. You should be less organized:
There are organizational charts as well as major divisions which are designed for the system of railway. Every individual should bring a team of experts and that team should be so flexible so that they can allow people who are involved in a project to freely discuss the concept through development. Nothing new has to be executed in an assembly line of fashion.

3. Collaboration matters and here's how you can do it:

With the audience:
You have to collaborate first. For this, you have to listen carefully. Understand what your audience needs, introduce yourself and contribute as well. Once you have managed to build a strong rapport, you can begin to ask questions. Give them value and you will receive value. The masses might not come up with the best idea but can definitely help some of the experts in refining it into something which they can easily engage into.

Collaborate externally:
Here you should pay very close attention to people who are on the edge. This includes the entrepreneurs, those who invent and people who influence in niche areas. In the past few years, their output is of having a major impact on the socioeconomic landscape. They will surely not have those titles or even the expense accounts that you are used to, but they also have to be as competitive as possible.

Collaborate internally:
You should set a few common goals and then ask a whole variety of experts so that it can be considered. And make sure you have the whole team for the process. Just because a person has nothing to do with the issues as such, it doesn't mean that they don't have any ideas related to the solution. Anybody could help you during any minute. So let the whole team sit together.

Reasons for Organizational Restructuring:

1. Changed Nature of Business
In today's business environment, the only constant is change. Companies that refuse to change with the times face the risk of their product line becoming obsolete. Because of this, businesses experiment with new products, explore new markets, and reach out to new groups of customers on a continuous basis. Businesses seek to diversify into new

areas to increase sales, optimize their capacity, and conversely shed off divisions that do not add much value, to concentrate on core competencies instead.

All such initiatives require restructuring. For instance, expansion to an overseas market may require changes in the staff profile to better connect with the international market, and changes in work policies and routines to ensure compliance with export regulations. Starting a new product line may require changes in the system of work, hiring new experts familiar in the business line and placing them in positions of authority, and other interventions. Hiving off unprofitable or unneeded business lines may require changes to retain specific components of such divisions that the main business may wish to retain.

2. Downsizing
One common reason for restructuring a company is to downsize the workforce. The changing nature of economy may force the business to adopt new strategies or alter their product mix, making staff redundant. Similarly, cutthroat competition and pressure on margins from competitors who adopt a low price strategy may force the company to adopt lean techniques, just in time inventory, and other measures to cut input costs and achieve process efficiency.

In such situations, the organization will need to redo job descriptions, rework its team, group, and communication structures and reporting relationships to ensure that the remaining workforce does the job well. Very often, downsizing-induced restructuring leads to a flatter organizational structure, and broader job descriptions and duties.

3. New Work Methods
Traditional organizational systems and controls cater to standard 9 AM to 5 PM office or factory based work. Newer methods of work, especially outsourcing, telecommuting, and flex time require new systems, policies, and structures in place, besides a change in culture, and such requirements may trigger organizational restructuring.

The presence of telecommuting employees, temporary employees, and outsourcing work may require a drastic overhaul of performance management parameters, compensation and benefits administration, and other vital systems. The newer work methods may, for instance, require placing emphasis on the results rather than the methods, flexible reporting relationships, and a strong communication policy.

4. New Management Methods
Traditional management science recommends highly centralized operations, and the top management adopting a command and control style. The **new behavioral approach to management** considers human resources a key driver of strategic advantage, and focuses on empowering the workforce and providing considerate leeway to line managers in conducting day-to-day operations. The top management intervenes only to set strategy and ensure compliance; strategic business units receive autonomy in functioning.
Traditional management structures were bureaucratic and hierarchical.

Of late, management experts see wisdom in flatter organizations with wider roles and responsibilities for each member of the team. Job flexibility, enlargement and enrichment are key features of such new structures, but successful implementation requires changes in the communication and reporting structures of the organization. While new organizations can start with such new paradigms, old organizations have to restructure themselves to keep up with these best practices to remain competitive.

5. Quality Management

Competitive pressures force most companies to have a serious look at the quality of their products and services, and adopt quality interventions such as Six Sigma and Total Quality Management. Implementing new quality standards may require changes in the organization. Most of the new quality applications strive to imbibe quality in the actual work process rather than maintain a separate quality control department to accept or reject output based on quality specifications.

In many cases, an organizational level audit precedes quality interventions, and such audits highlight inefficiencies in the organizational structure that may impede quality in the first place. For instance, reducing waste may require eliminating certain processes, and thereby reallocation of personnel undertaking such activities.

6. Technology

Innovations in technology, work processes, materials and other factors that influence the business, may

require restructuring to keep up with the times. For instance, enterprise resource planning that links all systems and procedures of an organizational by leveraging the power of information technology may initially require a complete overhaul of the systems and procedures first.

Such technology-centric change may be part of a business process engineering exercise that involves redesigning the business processes to maximize potential and value added, while minimizing everything else. Failure to do so may result in the company systems and procedures turning obsolete and discordant with the times.

7. Mergers and Acquisitions

In today's corporate world, where survival of the fittest is the maxim, mergers and acquisitions are commonplace and any merger or acquisition invariably heralds a restructuring exercise. The reasons for such restructuring accompanying mergers and acquisitions are many. Some of the common reasons are:

- Reconciling the systems and procedures of the merged organizations to ensure that the new entity has consistency of approach.
- Eliminating duplication of work or systems, such as two human resource or finance departments.
- Incorporating the preferences of the new owners, and more.

Joint ventures may also require formation of matrix teams, special task forces, or a new subsidiary.

8. Finance Related Issues

Very often, small and medium scale businesses have informal structures and reporting relationships, and an ad-hoc style of decision-making. When such companies grow and want to raise fresh funds, venture capitalists and regulations might demand a more professional set up, with formal written-down structures and policies. A listed company may undertake a restructuring exercise to improve its efficiency and unlock hidden value, and thereby show more profits to attract fresh investors.

Bankruptcy may force the business to shed excess flab such as workforce, land, or other resources, sell some business lines to raise cash, and become lean and mean, to attract bail-outs or some other rescue package. Companies may try to restructure out of court to avoid the high costs of a formal bankruptcy.

9. Buy Outs

At times, the restructuring exercise may be the result of the whims and fancies of the owners. For instance, the company may have a new owner who wants to stamp his or her personal authority and style onto the business. Restructuring allows the new owner to:

- Reshuffle key personnel and provide power to trusted lieutenants.
- Start with a clean state and thereby exert greater control.
- Preempt any inefficiencies that caused the previous owner to sell-out, and more.

With or without ownership change acting as a trigger, company owners may appoint a management consultant to review the company and suggest macro-level changes, as a routine exercise.

10. Statutory and Legal Compliance

At times, restructuring may be a forced exercise, to conform to some legal or statutory requirements. For instance, the government may mandate financial and healthcare institutions that deal with sensitive personal data to monitor their computer networks. A new bill may require that private computer networks adopt the same security measures that government networks adopt, to gain immunity from liability lawsuits in the eventuality of cyber attacks.

Any organizational restructuring is basically a change initiative. Success depends on managing resistance to change by convincing the remaining workforce of the need for change and the possible benefits, an effective communication system to lend clarity to the change process, and effective leadership.

Organizational Restructuring Strategies:

Some basic principles and strategies you must keep in mind before you plan on restructuring the organizational structure and design. Read them carefully before making final decisions.

1. Align the organizational structure:

All organization restructure have to be aligned to strategy. This could seem slightly self-evident to some of you but there are some organizations that fail to do so. For example, if local conditions happen to an important factor, then you should stress on local sales as well as marketing functions instead of a centralized behemoth which tries to matrix using a few local elements.

2. Cut down on the complexity:

If we put things in simple terms, then complexity does cost quite some money. Whether the organizational design and structure is complex, a product is complex and will offer a transactional process, the added cost of complexity shall also drag the performance a bit further. However there are three things that will help you in the organizational design. Some important principles you should remember include avoid making the roles of leadership too confusing or complex. Also remember to minimize the use of matrices. If you don’t, it could cause a lack of clear direction.

3. Focus on having better activity:
Always remove any sort of inefficiency that could hamper the process of organization restructuring. This means that you have to know what people are doing at this point so that the chances of danger has been reduced. You must have a good understanding of the tasks by role. This will also make sure that value added activities have been thrown out when removing a role is required. Similarly when it comes to duplication and the redundant activity, it can be easily removed at the time of restructuring a company.

4. Creating roles that are feasible:
When you are assigning work to some of your people, don't ever overload them. Always remember that business restructuring strategy will always leave the organization with very few people which could leave you with very few people to work with. When you are applying downsizing strategies or restructuring organization or reducing the headcount, make sure that you understand the workload of these employees. But understand that there is difference between downsizing and restructuring an organization. This may also help you design the roles which are neither heavy nor are they too light. Furthermore, you must remember that role design should always take a close look at grouping skills. Packing a role with many distinct skill sets will reduce the number of candidates.
5. Balance your work properly and load of managers:
When we speak of management loading, we are actually talking about a lot of hard work. It could be troublesome in some cases. Often its the inability of some managers to focus on leadership tasks because of expected output requirements. For example, the time which is spent on monitoring as well as coaching staff drop-offs could lead to several issues and errors caused by the staff itself. As a result of this, the manager ends up resolving the problem. To make sure, it is important to balance three elements that include the staff which is directly supervised and managed, the ability of the staff to do work without any supervision and the amount of work that managers have to do to stay on top of their activities.

The Implications of Restructuring an Organization:
Restructuring of organization happens usually in almost every organization. The reasons can be any like business growth, adding few departments or downsizing the existing structure. Such steps are taken for the betterment of business in all ways. Some of the methods through which the restructuring serves are,

- Improved Efficiency
- More Administration Work
- Cost Implications
- More Control
- Cultural Changes
- Speculative roles & responsibilities
- Productivity/KPIs below the standards
- Lack of leadership
- Under or Over-investment
- Decreasing or flat revenues
- Budgets for marketing are granted inefficiently
- Few internal reasons behind the corporate restructuring:
- Lower gross margin
- Poor internal communication
- Higher cost of operating
- Bad cash flow

- Lack of proper designs of processes
- High labour costs
- Few external reasons behind the corporate restructuring:
- New trends in the consumer/client sector
- Implementing strategies that redefine the market
- Due to the competitor's actions, the share market of the company decreases

Benefits of Organizational Restructuring:
The good thing about company restructuring plan is that the cost of operations could decrease in the future. An example can be used to explain this. The payroll expenses will be much lower if the businesses have dismissed some of the employees. Likewise, there are outsourced operations which are usually less expensive than those in-house labour. When some business eliminates a few layers of management during the process of communication, decision making and restructuring strategy could be introduced. For example, the records could become much easy to access if any business plans on implementing a filing system that is computerized.
Before we go, here are some final tips that can make the process of organizational restructuring much easy at your workplace!

Communication and Education:
Whether you are choosing to roll out new benefits towards the beginning of a new year or amending a new plan so that the benefits can be provided easily, communication is something that can easily help. Employees always care a lot about their benefits so they could hesitate about any of the changes which are being made. You should remember to communicate with the team members more frequently and in an open manner. Always invite their feedback and let them know about your new plans. Have meeting sessions where you can answer important questions. Offer a grace period to them so that they can allow employees to opt out of the benefits plan that is new.

Decide which plan would work well:
There are two benefits that come with planning. If the plan is defined, then some of the benefits of the employees have been defined and the employer will also have an obligation so that the promised benefits can be funded. Secondly, it is about having a contribution that is defined. Here the contribution will always be predetermined and the employer will be obligated to pay the amount for every employee. There are times when employees want to change a plan to one that has defined a contribution which could be more cost effective and much less risky. But always remember that the benefits have to be tailed so that it feeds the needs of the employees.

Actionable Steps for the Restructuring Process:
The restructuring process is an unavoidable phase in the development of the company. You may also encounter few obstacles for the completion of a process like corporate obstacles or resistance from employees. But for the success rate and growth of the company, restructuring has become a mandatory process that needs to be accomplished.

There also happens times when the focus of the restructuring changes which no longer will be helpful for the organization. So, it is necessary to imbibe and follow a few strict rules during this process. Some of them are,

1. Planning

2. Organizing
3. Testing
4. Full execution
5. Analysis process
6. Plan correction

All these steps form together as a restructuring cycle.

With this, we would like to bring the post to a close. If you have enjoyed reading the article, found some benefit from it and would like to tell us about it, please do leave your comments in the box below. We would be more than happy to help you. Also if you have questions in mind, drop them down as well. We will try our best to answer all of them. On that note, good luck!

Mergers & Consolidation

In the business world, the terms merger and consolidation are used quite often. Pretty surprisingly, they are also mistaken more often and interchanged with each other. It will not come out as a new thing to hear someone say their company merged with another one yet it was a consolidation and vice versa.

The main similarity between a merger and consolidation is that they both involve companies coming together as one. The companies usually come together to combine their assets, increase their market shares, as well as to grow profits.

Basically, mergers are different from consolidation, but they essentially follow the same process. In order to understand the difference between the two, a clear dissection of the two words needs to be made. Each term needs to be given its definition and characteristics. Examples of each would also play a big role in differentiating them.

What is A Merger?

A merger is defined as a contractual and statutory combination of two or more entities or things, mostly companies when they join into one. Also, it can be understood to be the process in which a company takes over another one including its assets and liabilities.

While the company taking over remains active, the other one essentially ceases to operate. A good example would be having three Companies, A, B, and C operating at the same time. Companies A and B merge into company C where C continues to exist, but A and B cease to exist. A merger is usually beneficial to small companies that join or get taken over by a larger one for better brand recognition or market traction.

What are the Major Reasons Why Companies Merge?

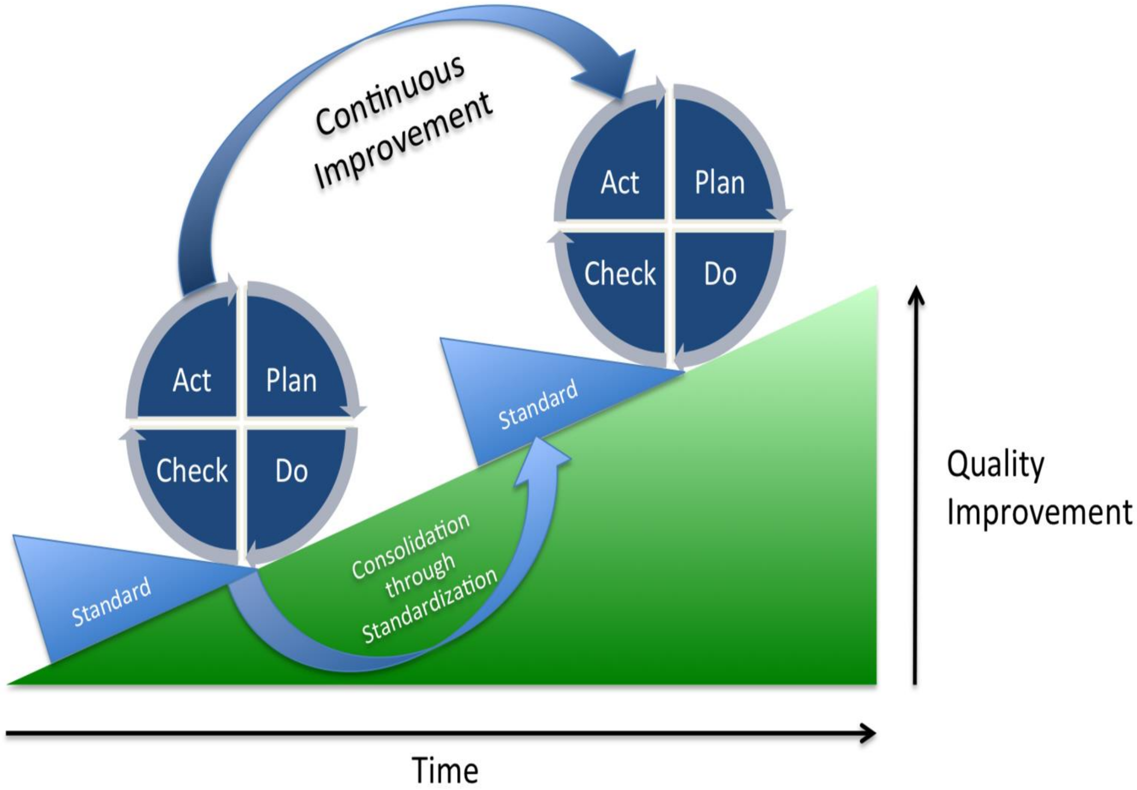
Companies can come together in a merger due to several reasons. Some of the inducing factors include:

- Economic necessity
- Economics of sale
- Operating economies
- Synergy
- Diversification
- Growth
- Better financial planning
- Utilization of tax shields
- Elimination of competition

- Increase in value

Major Benefits of a Merger
Companies enter into mergers with expectations of better days in business ahead. Among the major benefits of mergers are:

- Increased goodwill
- Tax benefits
- Entry into more markets.
- Combined forces to face competition.
- Increased financial resources.
- More growth and expansion.
- Increased market share.



What is the Meaning of Consolidation?
Consolidation, on the other hand, is defined as a contractual and statutory process or action where two or more entities come together to form a more solid or stronger entity. When a consolidation happens, the corporations joining hands become a completely new corporation, at this moment called the successor corporation.

For a consolidation, unlike a merger, the originals entities cease to exist altogether. The *successor corporation* acquires all assets and liabilities that the original entities owned before they came together.

What are the Major Reasons Behind Consolidations?
The top five reasons why companies decide to venture into consolidation are:

- Streamlining the management and improving decision making.
- Saving resources, money, and to reinvest funds.
- Launching new services in faster and easier ways.
- Improving security
- Streamlining provision of customer services.

Notable Benefits of Consolidation

When companies enter into a consolidation, they enjoy benefits such as:

1. Established and uniformed operation procedures.
2. Reduced costs through economies of scale.
3. Elimination of redundancy.
4. Lowered overhead expenditures.

Differences between Mergers and Consolidation

1. **Meaning**
   A merger is a statutory and contractual combination of two or more entities or companies into one while consolidation is the contractual and statutory process where two or more entities, usually companies join hands to form a completely new, more solid, and stronger entity.

2. **Formation**
   For a merger to happen, two or more companies come together and combine forces where the company taking over is left as the existing entity. Consolidation, on the other hand, takes place when different ventures come together, combine forces, and join into one completely new venture. The old entities cease to exist altogether.
   In short, A + B = C when it's a consolidation and A + B = A if it's a merger.

3. **Resultant Entity**
   In the case of a merger, the company absorbed will cease to exist and only the acquiring company continues to exist. In the case of a consolidation, all the companies involved stop existing, and a new large company is formed.

4. **Other Names**
   The other name for a consolidation is absorption while the other name for a merger is fusion. Even though amalgamation is sometimes used in place of merger, the two, merger and amalgamation also have some distinctions.

Merger vs Consolidation

Comparison Table

Characteristics	Merger	Consolidation
Meaning	A statutory and contractual combination of two or more entities into one new entity. The company taking over continues existing	A contractual and statutory process where two or more ventures or companies join hands to form a completely new one
Form	Two or more companies come together and combine forces. The company taking over is left as the existing entity	Happens when different ventures come together and combine forces into a better and stronger venture
Resultant entity	The company absorbed will cease to exist	All the companies involved will cease to exist

Even though the two terms are common in the business world, it is apparent they are varied. The variances are deeply entrenched into the forms each take and the factors surrounding it. All in all, the two terms involve two or more business ventures or companies coming together as one for better business opportunities and market traction.

Scenario of Mergers and Consolidation in India- The Banking Industry

The big news of late in the financial sector is govt's decision to merge public sector banks, trimming their number from 27 to 12 over the next couple of years or so. Finance Minister Nirmala Sitharaman unveiled a plan that will merge as many as 10 public sector banks into four entities. As the centre attempts to boost economic growth following a six-year low, this consolidation is expected to create fewer, and stronger, lenders. Sitharaman announced the merger is being undertaken in order to revive and revitalise the banking

sector to stay on course for the govt’s stated target of touching $5 trillion as an economy. Apart from the merger, the centre announced that Rs 55,250 crore upfront capital will be infused into the PSBs.
As the disappointment over the underwhelming 5% GDP growth last quarter grows, the second merger of public sector banks in recent times is, according to Mint, “the widest rearrangement of the banking sector since the nationalisation of 14 banks in July 1969.”

By digging deeper, we look at the merger in some detail, what it means for the sector, and also take a look briefly at what the future could look like for the banking sector in India.

27 become 12
Nirmala Sitharaman announced four new mergers. Three banks - Punjab National Bank, Oriental Bank of Commerce, and United Bank of India - will combine to form what will become India’s second-largest lender. That entity will have a combined total of 18 lakh crore business, with India’s second largest branch network - 11,437 branches.

Canara Bank and Syndicate Bank will merge to form another large entity which will be the fourth largest PSB, with business worth 15.2 lakh crore. It will have 10,324 branches - the third largest network in India.

Merging Union Bank of India with Andhra Bank and Corporation Bank will create the country’s fifth largest PSB, with business worth Rs 14.6 lakh crore, and 9,609 branches - the fourth largest network.
When Indian Bank merges with Allahabad Bank, the new entity will be the seventh largest PSB, with Rs 8.08 lakh crore of business.

According to Business Today, these new entities will control “two-thirds of India's banking in terms of advances and deposits are meant to create a stepping stone to India's $5 trillion GDP target.” Here’s a number that will make all this PSB merge business easier to remember:

India will have 6 large public sector banks with Rs 10 lakh crore-plus balance sheets, two national banks and four regional banks.

Indian Overseas Bank, Uco Bank, Punjab and Sind Bank, and Bank of Maharashtra - these banks have a strong regional focus and will continue to operate as separate entities. Bank of India and Central Bank of India will also continue to operate separately as before. For PSBs as a whole, there will be 12 public sector banks in place of 27 public sector banks in 2017. Those 12 will include State Bank of India and Bank of Baroda. Sitharaman said such consolidation of public sector banks will give them scale.

The centre also announced and upfront capital infusion of Rs 55,250 crore for credit growth & regulatory compliance to support the economy. PNB will receive 16,000 crores; Union Bank 11,700 crores; Canara Bank 6,500 crores; Indian Overseas Bank 3,800 crores; Central Bank of India 3,300 crores; Bank of Baroda 7,000 crores; Indian Bank 2,500 crores, and Uco Bank will receive 2,100 crores. United Bank will see an infusion of 1,600 crores while Punjab and Sind Bank will get 750 crores from the centre.
Ms Sitharaman also announced other measures over the last few weeks that were intended to help lift India’s economy as an increasing number of indicators show it slowing down. According to the Economic Times, she announced a “rollback of the super-rich tax on

foreign and domestic equity investors, exemption of startups from 'angel tax', a package to address distress in the auto sector...in an effort to boost growth” besides the infusion of capital into public sector banks.

She also claimed gross NPA level has come down heavily and that the centre is monitoring large loans to avert frauds. She also claimed that the sanctioning and monitoring of loans have been separated, and special agencies have been formed to monitor loans above Rs 250 crore to avoid a Nirav Modi-like situation.

This is not the first consolidation of public sector banks - in 2018, the centre approved the merger of Vijaya Bank and Dena Bank with Bank of Baroda that become effective from the start of the current fiscal. That merger created a new, improved Bank of Baroda that is the third-largest bank by loans in the country. The govt claimed no retrenchment, or layofffs, had taken place after the merger of Bank of Baroda, Dena Bank and Vijaya Bank, and that “the staff has been redeployed and best practices in each bank have been replicated in others.”

In 2017, State Bank of India absorbed five of its associates - State Bank of Patiala, State Bank of Bikaner and Jaipur, State Bank of Mysore, State Bank of Travancore and State Bank of Hyderabad- and the Bharatiya Mahila Bank.

The FM added that in order to make managements accountable to their respective boards, a board committee of nationalised banks will appraise the performances of seniors like general managers, managing director etc. According to a report in Mint, “Post consolidation, the boards will be given flexibility to introduce chief general manager level as per business needs. They will also recruit chief risk officer at market-linked compensation to attract best talent.” Further, Risk Management Committees of banks will be empowered to veto management decisions and the banks board bureau will conduct leadership programs for bankers.

Does it actually help?

The government has listed three broad gains from the consolidation. They called it 'Unlocking potential through consolidation'. Let’s examine them briefly:

The first benefit is enhanced capacity to increase credit. The consolidated entities will have a higher capacity to lend, but also need capacity building, especially in project appraisal, risk management and monitoring. A bank like SBI, with its huge balance sheet, has also found itself in trouble with similar asset quality issues as other PSBs.

The second gain the govt claimed is strong national presence and global reach. But these PSBs already control two-thirds of all banking in India. As far as global reach goes, Indian banks have a lot to catch up. Competition from private banking institutions is eating into the share of PSBs, thanks to better digitisation, faster processing of loans, and much better customer service.

The third potential gain is the operational efficiency gains that reduce the cost of lending. This is one area where the entire operating model has to change. PSBs still operate in an old fashioned manner. Banking has changed significantly in the last decade, with product-focused banks. We now have retail banks, small finance banks, payments banks and more. Meanwhile, PSBs seem to be caught in the relatively outmoded loop of corporate banking while private banks are exiting the space due to asset-liability management issues.

One analysis in Business Today, writing about PSBs, concluded, “The PSB model of banking with government ownership, control and also lending support to government's agenda (priority sector, financial inclusion, Mudra, etc.) has been a big stumbling block for bringing about a change in their functioning. The merger announcement doesn't address the core structural and fundamental issues plaguing the PSBs. The setting up of Banks Board Bureau...was path-breaking, but this model was not pursued to its logical end. The power of BBB was restricted only to appointments of senior management and directors. The government didn't extend BBB's scope to human resource (HR) reforms, NPA and stressed assets resolution, risk management, etc.”

That said, the mergers are all somewhat similar in nature. Prakash Agarwal, Head - Financial Institutions at India Ratings, observed, "The mergers are mostly among larger banks with absorbing bank not necessarily in strong health.” They all face similar issues like falling profitability, asset quality deterioration, an ageing workforce, and laggardly approach to digitisation. They all are also corporate banks in nature while retail banking is still very small.

Rating agency Moody's upgraded the outlook on Punjab National Bank yesterday from 'stable' to 'positive'. PNB is, as mentioned earlier, slated to merge Oriental Bank and United Bank of India with itself. The agency said PNB receiving a positive outlook reflects Moody's view that the bank's baseline credit assessments are likely to improve following capital infusion from the government, and its financial metrics will also gradually improve. That said, Moody's did caution that it could lower PNB's BCA and ratings, or change the rating outlook to stable, if asset quality, profitability, and capital deteriorate on a standalone basis or as a result of the merger.

It was suggested at a meeting by the 10 banks that they should form joint committees on various verticals, under an apex committee to oversee the process. For instance, different committees with representatives from all of the entities to be merged could work on various parts - like risk management, products, technology or policy. The apex committee for the merger will anchor the process. Business Standard reported that the meeting was anchored by the ministry of finance, and the more on processes considering the many statutory and legal stipulations involved in a merger. Many senior pros across all the banks are involved in the world on the mergers.

One of the bankers said, “We do not want the feeling of large banks taking over control of small banks to dominate the process. Best practices of various banks will be adopted to get business benefit for an organisation, post merger. The priority is minimal disruption to business and customers.” Meanwhile, Rajkiran Rai, MD and CEO of Union Bank of India, said it was more of learning from Bank of Baroda’s experience of merging with Vijaya Bank and Dena Bank.

State Bank of India Chairman Rajnish Kumar said the biggest advantage is that bigger banks have greater ability to absorb shocks, reap economies of scale as well as the enhanced capacity to raise resources without depending on the exchequer.

That is, of course, no guarantee of success. SBI itself is an example. As Business Today pointed out, India's largest bank does not figure in the top quartile in terms of performance. An analysis in BT explained the situation like this: "Product differentiation is completely missing and it seems the technology platform was one of the major drivers for deciding the banking mix of banks. Do we need more clones of each other? Experts suggest there should be a differentiation in terms of product category, say SME or emerging corporate-focused banks or purely retail banks or large corporate banks. Currently, there are specialised banks in the market. For instance, HDFC Bank, Kotak Bank, etc. are emerging as retail banks. There are Bandhan Bank and a host of small finance banks that are focused on catering to unbanked and underserved segments of microloans. In a slowing economy where the asset quality deterioration of PSBs has still not receded, the merger move could be counterproductive."
Anil Gupta, Vice President at rating agency ICRA, told BT, "The choking of management bandwidth should not result in a slowdown in credit flow to the economy."

On the other hand, an analysis in BloombergQuint approved of the centre's move. The report said, "This initiative is a welcome move in the right direction...One of the causes for the slowdown was the reduction in lending following the financial problems we saw from the IL&FS issues since last September. Consequently, the banks started going slow on lending to NBFCs, which in turn did not have the money to lend for purchases of cars, two-wheelers, houses, etc. That aggravated the slowdown caused by poor and erratic monsoon as well as the lingering effects of demonetisation and GST. This initiative by the central government is a measure to help improve banks in their capital adequacy."

That analysis also explained that the central government, the owner of the PSBs, is trying to improve the governance of these banks. We have witnessed in the past how ineffectively these organizations were run. There were news reports on lending decisions being made not on merit but based on other considerations. Bloomnberg's column explained, "The improvement in governance is focused on objectives sought to be achieved, systems and processes within the bank itself, merit-based lending and oversight by the board. The government had taken a decision in the past on the separation of the role of the chairman and the managing director—earlier the public sector banks were run by one person who was chairman and managing director, but this separation is not efficiently implemented. It should be implemented immediately by giving...more powers to the chairman so that the chairman has some oversight and responsibility over the board and also over the chief executive officer."

According to Moody's, the govt's measures also give rise to some execution challenges and do not yet reflect the potential positive impact on the banks' ratings. It is worth noting that public sector bank shares
have been on a selling spree following the government announcement to merge banks.

What do the experts say?
PNB's MD and CEO, Sunil Mehta, said this merger will be beneficial for the banking system, and the country as a whole. He said the merger of three banks will bring a lot of synergies into the existing entities and that the capital infusion announced by the government for the merged entity is adequate. He added, "All the requirements of the bank, including the minimum regulatory requirement as well as the growth requirements have been completed while working out the Capital infusion."

Canara Bank MD and CEO RA Sankara Narayanan said the move will provide better opportunities to do quality business. He explained, “we will be taking the proposal to the board in the next 7-10 days, and once we get the approvals from the government and the gazette notifications, the actual integration may happen sometime in first week of April.”

Arundhati Bhattacharya, former chairman, State Bank of India, told ET, “I have always said that India needs bigger banks…many PSBs were sub par in size and this merger will help them...The kind of investments one needs to make in compliance and technology is enormous and…the return on investment is not enough (for smaller banks). The bigger the entity, the stronger you become.”

Kuntal Sur, partner at PwC India, said, “All these banks were thin at the top because they were struggling to get good quality GMs and CGMs, and these mergers will create the bandwidth for better midmanagement. This will, in turn, help in better loan monitoring, overseeing the end-use of funds, and better recovery.”

Saurabh Tripathi, partner, Boston Consulting Group, explained, “A bigger bank helps in more independent decision making. SBI is a case in point...Its size and scale allow its management the bandwidth and stature to deal with government ministries with confidence and make faster decisions. The smaller banks still wait for government signaling.”

Conversely, a report by Credit Suisse claimed the merger is unlikely to revive credit growth or have meaningful cost synergies. The report said, “Coupled with the ongoing moderation in growth for private banks led by auto sector slowdown and increased cautiousness, credit growth, thus, is unlikely to be revived by PSB mergers." It explained that the merger is unlikely to meaningfully revive the flow of credit to the liquidity pressed NBFCs - given the already high share of NBFC exposure in constituent banks, the four new entities will have more than 10% of their loan exposure towards NBFCs.

About cost synergies, the report said that “the limited flexibility on restructuring and rationalisation indicates that meaningful cost synergies from PSB mergers are unlikely. While the large recapitalisation improves the capacity for banks to grow loans, recent experience of State Bank of India and Bank of Baroda indicates that focus on integration impacts near-term growth .” The report summarized that the merged banks will continue to depend on external infusions inviting frequent dilutions.
Taking a middle path, a report by Centrum Broking Research claimed, “In our opinion (and going by recent precedence), consolidation has generally been near-term detrimental to the stronger (acquiring) banks and an extended integration period remains a challenge for these entities...We believe the proposed mergers will face near-term challenges by way of integration of processes, human resources, consolidation of financials, and branch network rationalisation. The report claimed the consolidated banks will likely see an improvement in economies of scale and efficiency of operations over the medium-long term.

Acquisitions & Takeovers
In the corporate world, the terms merger, acquisition, and takeover are quite commonly used to describe a scenario in which two companies are joined together to act as one. There maybe many reasons for two companies to combine their operations; it maybe in a friendly manner with agreement from both parties or in a hostile unfriendly manner. The

following article provides a clear explanation of what the two terms mean and outlines how they are different and similar to each other.

Takeover

Takeover is very similar to an acquisition where one company will purchase another for an agreed sum in cash or number of shares. The important point to note is that, as the term suggests, a takeover will most probably be a hostile and unfriendly action in which one company acquires enough shares of another (more than 50%) so that the acquirer is able to take over the operations of the target company. A takeover may also be a friendly one, in which the company that wishes to acquire the target may take an offer to the board of directors who may (in a friendly takeover) accept the offer if it seems beneficial to the future operations of the target company.

Hostile Takeovers

Hostile takeovers occur without the consent of the acquired firm's board of directors. The first step of a hostile takeover includes the acquiring firm taking over the company through a tender offer or proxy fight. Hostile takeovers through tender offers involve the acquiring company purchasing the shares of the target firm directly from shareholders, or on the secondary markets. Shares of a stock represent ownership of a company. Therefore, buying all or a majority of the company’s shares allows the acquiring company to possess ownership of the target company. To purchase shares, the acquiring corporation offers a higher price to shareholders than the market value of the stock. A proxy fight involves the acquiring company seeking the voting rights of the target firm's shareholders to win control of the target's firms board of directors. The last step involves filing a 30-day acquisition notice with the Securities and Exchange Commission and the target firm's board of directors. After receiving the notice, the target company must formulate defensive tactics, or risk a hostile takeover.

Defending Against a Takeover

Some target companies implement defensive tactics to prevent a hostile takeover. Undervalued public companies are more vulnerable to hostile takeovers, because the public owns the majority of the company’s shares. A preventive measure includes a company buying a sizable portion of its own shares, which prevents the acquiring company from purchasing the shares and becoming the majority owner. A company may file an anti-trust lawsuit against the acquiring firm in an attempt to defend itself from takeover, or restructure its assets and liabilities to prevent another company from financially benefiting from a takeover.

Acquisitions

Companies acquire other firms to increase their market share, obtain new facilities and acquire advanced technology. In an acquisition, the board of directors of an acquired firm agrees to allow another company to control the firm for a certain price. The firm making the acquisition usually agrees to purchase the acquired company’s assets or stock. Purchasing the assets allows the acquiring company to avoid needing shareholders' approval. The company desiring to make the acquisition must perform due diligence before the acquisition process begins.

An acquisition is quite similar to a takeover, in that, one company will purchase the other; however, it is usually on a pre-planned and orderly manner in which both parties strongly agree if beneficial to both firms. In an acquisition, the company that acquires the target will be entitled to all the target company’s assets, properties, equipment, offices, patents, trademarks etc. The acquirer will either pay in cash to acquire the firm or provide shares in the acquirer's firm as compensation. In most cases, after the acquisition is complete the target company will not exist, and would have been swallowed up by the acquirer and will operate as an indistinguishable part of the larger acquirer firm. In other instances, the target may also operate as a separate unit under the larger firm.

Takeover vs Acquisition

Acquisitions and takeovers are quite similar to each other, and in both acquisitions and takeovers, the acquirer firm purchases the target and both firms will operate as one larger unit. The reasons for which either an acquisition or takeover occurs is also quite similar, and usually occurs because combined operations can benefit both firms through economies of scale, better technology and knowledge sharing, larger market share etc. During both an acquisition and takeover, the acquirer is entitled to all assets as well as liabilities of the target firm. The only major difference between the two is that a takeover is usually a hostile act, whereas an acquisition is usually an agreed upon well planned operation.

Takeovers and acquisitions are common occurrences in the business world. In some cases, the terms takeover and acquisition are used interchangeably, but each has a slightly different connotation. A takeover is a special form of acquisition that occurs when a company takes control of another company without the acquired firm's agreement. Takeovers that occur without permission are commonly called hostile takeovers. Acquisitions, also referred to as friendly takeovers, occur when the acquiring company has the permission of the target company's board of directors to purchase and take over the company.

Acquisition Process

The first step of a friendly acquisition includes developing a strategy and researching the financial benefit of acquiring the target company. Acquiring companies must know the resources needed to purchase another company. The next step in the acquisition process includes identifying and performing a valuation of the target firm. Companies perform valuations by examining financial statements, identifying market positions, researching legal obligations and performing a SWOT analysis on the target firm. After the valuation process, a company must determine how much the target company is worth, and the best way to raise the resources needed for the acquisition. The last step includes both companies agreeing to the terms of the acquisition and meeting all legal requirements.

Summary:

• Acquisitions are takeovers are quite similar to each other, and in both acquisitions and takeovers the acquirer firm purchases the target firm and both firms will operate as one larger unit.
• A takeover is usually a hostile act, where the acquirer will surpass the target company's board of directors and will purchase more than 50% of the shares to obtain a controlling stake in the firm.
• An acquisition is quite similar to a takeover in that one company will purchase the other; however, usually on a preplanned and orderly manner in which both parties strongly agree if beneficial to both firms.

Latest Acquisitions in India

Unlike 2018, India witnessed a downward trend in the M&A transactions during the year 2019 both in volume and deal numbers, however, M&A activities saw a spur due to sale of distressed assets under Insolvency and Bankruptcy Code (IBC). IBC although in its nascent stage has already garnered a lot of investor attention to be classified as an M&A category in itself, exclusively involving distressed assets.

This is also evident from the India M&A Report 2019 published by Bain & Company in collaboration with Confederation of Indian Industry (CII) wherein they account that 70% of the of growth in M&A activity in 2018 was led by distressed deals, enabled through the corporate insolvency resolution process under IBC.

The year 2019 saw some remarkable foreign investments across various industry segments making its way into the country albeit the downward trend, the details of a few are as follows:

- Acquisition of a majority stake of 71% in Yatra for $337.8 Mn by Ebix Inc.
- Lately, Edtech Companies are also catching investor attention through deals like Blackstone Partners-Aakash Educational Services Limited and Byjus's-Qatar Investment Authority (QIA) investments.
- Acquisition of Aadhar Housing Finance Limited by the Blackstone Partners and other deals in the sector include investment of $250 Mn by the CDPQ in the non-banking arm of Edelweiss Group named ECL Finance Limited.
- 4% stake pick by total S.A. for $864 Mn in Adani Gas Limited being the largest FDI investment in the highly regulated gas distribution sector.
- Logistics sector being the arm of e-commerce business saw foreign investments in the form of Delhivery-Canada Pension Plan Investment Board (CPPIB) and Shadowfax-Flipkart deals.

Key Events and Trends That Dominated M&As In 2019

The global economic slowdown and the growing tensions steered by the US-China trade war triggered a likely restrained approach concerning M&A activities in the world. This uncertainty around geopolitical landscape led to a corollary effect negatively impacting the investment activities in the previous year. In addition to the above, the investor sentiments in India were also conscious due to the 17th Lok Sabha elections in the country.

Besides IBC, the key trends dominating M&As was the dynamism of the present government to bolster the economy through its business-friendly initiatives. These initiatives introduced through reforms in the regulatory regime is apparent to offer a much needed impetus to the M&A activities in the country going forward. We enumerate below few of the reforms introduced during the year which may boost the M&A activities:

- SEBI's new framework on issuance of Shares with Differential Voting Rights which provides an effective tool to receive investments without losing control;
- Foreign Exchange Management (Cross Border Merger) Regulations, 2018 which happens to be another first of its kind piece of legislation;
- Code of Wages, 2019 which codifies four existing Labour Laws into one;
- Foreign Investment Regulations, 2019 (*classified as Debt and Non-debt Regulations*) which replaces the erstwhile TISPRO Regulations, 2017 and Acquisition of Immovable Property in India Regulations, 2018;
- Tax incentives and exemptions to registered startups.
- Reforms in the manufacturing sector advocating the 'make in India' campaign; and

- the Quintessential reform of reduction in the effective corporate Income Tax Rates thereby placing India onto the map of an attractive investment destination at par with most of the highly regarded investment destinations of the world.

It is also worth noting that quite a few M&A deals in the startup ecosystem namely, acquisition of Nightstay by Paytm, acquisition of Fastfox by Elara Technologies, CRIDS by Sachin Bansal and Wibmo by PayU.

Start-up acquisitions in India

In the context of mergers and acquisitions in India, the one development that's on top of everyone's mind is the Walmart-Flipkart acquisition in mid-2018. From the perspective of M&As in the country, that acquisition became a landmark moment and its effects are still rippling through the ecosystem.

Whether it was the hangover from that deal or the fact that the ecosystem has been more guarded in terms of M&As, this year the total mergers and acquisitions has gone down.

Until November 30, 2019, India saw a total of 86 acquisition deals, according to data recorded by Datalabs by Inc42. Here, Reliance stole the limelight with 11 M&A deals this year followed by Nazara Technologies which acquired three startups — Paper Boat Apps, SportsUnity and Bakbuck.

Although many large players were part of the M&A landscape this year, however, the number of deals decline as compared to previous years. For instance, between 2015 and 2018, the number of acquisition deals of increased by 9% y-o-y. However, in 2019, the number of deals decreased by approximately 27% as compared to the previous year.

Notably, this year, enterprise tech (18 acquisition deals) and fintech startups (12 acquisition deals) dominated the startup M&A chart, followed by media and entertainment (11 acquisition deals), consumer services (9 acquisition deals), healthtech (8 acquisition deals), ecommerce (8 acquisition deals), and traveltech (4 acquisition deals) among others.

Furthermore, during H1 FY19, there has been a 41% drop in M&A for seed-stage startups compared to H2 FY18. For growth-stage startups such as OLX Group, Nasara, OYO, Radware, Reliance Industries and Pine Labs, 2019 has been promising.

Reliance Industries on a Startup Acquisition Spree

It has been the busiest year for Mukesh Ambani-led Reliance's M&A team. While the company has evaluated more than 33 deals so far in the last 10 years, in 2019 alone it made 8 acquisitions.

While Reliance may be the showstopper here, there were quite a few other deals that also got our attention in 2019.

Top 10 Mergers & Acquisitions of 2019

Ebix Acquires Yatra

After acquiring ItzCash for $124 Mn in 2017, Ebix made its mark again this year by acquiring Indian online travel booking company Yatra through a merger deal for a value of $337.8 Mn. Through this partnership, the company will be strengthening its position in the India hotel and flight ticketing market.

In a statement the company had disclosed a value of $4.90 per Yatra's share, and the transaction implies an enterprise value of $337.8 Mn at the Ebix collar price of $59 per share and post adjustment for indebtedness, working capital, warrants to be converted and minimum cash requirement, a net equity value of $239 Mn.

Cisco Acquires CloudCherry

In October 2019, US-based Cisco acquired CloudCherry. Post-acquisition, Cisco will leverage CloudCherry's customer retention management platform to offer speed-to-insight for companies to offer tangible outcomes that help them drive good RoI.

CloudCherry was founded in 2014, by Vinod Muthukrihnan. The US and Bengaluru-based company work with global enterprise clients offering SaaS tools to enhance customer interaction and experience on websites. It provides software solution includes customer journey mapping, predictive analytics and more.

Pine Labs Acquires Qwikcilver

In March 2019, the online retail payments platform Pine Labs acquired Bengaluru-based digital gift card firm Qwikcilver Solutions for $110 Mn. After the acquisition, Kumar Sudarsan, cofounder and CEO of Qwikcilver joined the leadership team of Pine Labs.

The amalgamation of both companies will bring together the strengths of Pine Labs' merchant-focused and Qwikcilver's brand-centric software-as-a-service (SaaS) technology platforms, and augment their Indian and international market reach.

OYO Acquires Innov8

In March 2019, the hospitality chain OYO acquired Gurugram-based coworking startup Innov8 for INR 220 Cr ($31.84 Mn), in an all-cash deal. As per Inc42 sources, the founders and investors of Innov8 have taken an exit as part of the buyout.

The founder of Innov8 Ritesh Malik, post-acquisition, will drive the company's expansion under OYO. The team of Innov8 would continue to remain intact.

Graduated from Y Combinator in 2016, Innov8 which was founded in 2015 had raised over $4 Mn in funding from investors such as LetsVenture, Venture Catalysts, Credence Family Office, Rajan Anandan (VP India and Southeast Asia, Google), Vijay Shekhar Sharma (founder and CEO, Paytm), Girish Mathrubootham (founder and CEO, Freshdesk) among others.

Sachin Bansal Acquires CRIDS

Striking one of the biggest deals this year, former Flipkart CEO Sachin Bansal acquired Chaitanya Rural Intermediation Development Services Private Limited (CRIDS), a non-banking finance company (NBFC).

Bansal invested INR 739 Cr ($104 Mn) and took over as the CEO of CRIDS. In a media statement, Bansal said that this acquisition is his entry into the financial services world. He lauded the founders of the company to have built a great company that provides much needed financial access to underserved audience which is left out of the formal market.

Currently, it has a presence in Karnataka, Bihar, Jharkhand, Maharashtra and Uttar Pradesh. Post-acquisition, the cofounders will continue in their respective roles of growing the existing business segments.

Qoo10 Pte Ltd Acquires ShopClues

Just like the Walmart-Flipkart acquisition deal shook the Indian startup ecosystem last year, the acquisition of ShopClues also came as a shock for many. One of the earliest

unicorns in India, ShopClues was acquired in a stock deal by Singapore-based Qoo10 Pte Ltd.
Through this collaboration, ShopClues which has more than 700K small and micro-merchants will be able to reach customers in Qoo10's Southeast Asian markets. On the other hand, the company's statement added that Qoo10's merchants and cross border logistics business will get access to the Indian market.

PayU Acquires Wibmo For $70 Mn
In April 2019, Nasper-owned fintech company PayU acquired Bengaluru and Cupertino-based startup Wibmo in a deal worth $70 Mn. Through this acquisition, Wibmo in a statement had said that it will build a robust digital payment ecosystem to deliver its customers and clients a seamless payment experience.
Wimbo was founded in 1999, and the Indian operation was led by Govind Setlur. The company offers digital payment technology solutions and payment security in various countries. It offers 3D secure process of digital payments, the one-time passwords (OTP) gateway to authenticate digital transactions. Interestingly, Wimbo's platform is certified by Mastercard, Visa, RuPay, Payment Card Industry Data Security Standard (PCI DSS).

Quikr Acquires Zefo
With this acquisition deal, Quikr will be looking to scale its pre-owned goods and services verticle. Quikr founder and CEO Pranay Chulet said that the collaboration will further enable the company to offer a much broader selection of products at even more competitive prices. On the other hand, Zefo's offerings can now be offered to Quickr's large customer base.
Founded in 2015, Zefo was started by Arjit Gupta, Himesh Joshi, Karan Gupta, and Ramasubramanian. The company offers end-to-end operations, including product refurbishment and repairs of its sold products, where it ensures to provide a higher degree of standardisation.

Paytm Acquires NightStay
In January 2019, Paytm acquired travel startup and a last-minute hotel booking app, NightStay for an undisclosed amount. However, before this acquisition reports surfaced that Paytm may acquire NightStay for $20 Mn (INR 142 Cr).
NightStay was started by Nasr Khan and Deepak Negi in 2014. The company offers hotels open and flexible options to provide flash accessibility on its app. Currently, Nightstay is present in Delhi, Mumbai, Bengaluru, Goa, Chennai and Hyderabad. Previously, the company has raised funding of $500K in August 2015 from BedRock Ventures and angel investors Rajesh Sawhney and Shailesh Vickram Singh, a partner at SeedFund.

OLX Group Acquires Aasaanjobs
With the acquisition of Aasaanjobs, online classifieds marketplace OLX is making its bet on rapidly-growing recruitment industry in India. OLX company will utilise the acquired assets to strengthen its job verticals in the blue and grey collar jobs market

Since its launch in January 2008, OLX has expanded its vertical slowly with an acquisition-led strategy. Starting from 2015, the company has so far done three acquisitions with one acquisition in 2019. Previously, the company has acquired Sulit.com.ph and Torg.Uz.

Other Important Startup Acquisitions of the Year

Radware Acquires ShieldSquare

Through this collaboration, Radware will offer ShieldSquare's bot mitigation and management services under its new Radware Bot Manager product line. ShieldSquare will be integrated into Radware.

Elara Technologies Acquires FastFox

In April 2019, Singapore-based digital real estate marketing and transactions services company, Elara Technologies acquired Gurugram-based rental brokerage startup FastFox for INR 100 Cr ($14 Mn).

Scripbox Acquires Upwardly

In August 2019, personal wealth management platform Scripbox acquired another wealth management startup Upwardly for an undisclosed amount.

ClearTax Acquires Dose FM

In October 2019, the fintech startup ClearTax acquired Mumbai-based audio streaming platform Dose FM for an undisclosed amount. Through this acquisition, the team will be building mobile focussed products for simplifying the financial lives of businesses and individuals

Printo Acquires Inkmonk

In May 2019, the Bengaluru-based printing retail startup Printo acquired custom online printing marketplace Inkmonk for an undisclosed amount. Through this partnership, the founders of Inkmonk will be joining Printo's leadership roles.

Medlife Acquires Myra

In May 2019, Bengaluru-based epharmacy startup Medlife acquired medicine delivery startup Myra Medicines for an undisclosed amount. Through this acquisition, Medlife will be able to accrue profits and support its pharmacy business. Also, Medlife will consolidate and improve the delivery of medicines and extend the reach to more Indian cities.

Expected Trends In 2020 For M&As In India

As we set our foot forward in the new decade, we expect a lot of buzz in the M&A space of the country since the regulatory regime introduced earlier are tested in the real world. One of the key reforms introduced was incentivising of manufacturing facilities favoured by the reduced tax rates which may encourage setting up or acquisition of manufacturing facilities thereby inviting foreign investments directly or indirectly supplementing M&A transactions.

We also expect the future of M&A deals fostered by IBC at the forefront as entities envisage into expansion of its core/non-core vertical and horizontal businesses through buyouts to remain competitive in the markets.

Another lucrative trend, augmenting the M&A arena of the country would be *divestments* of group businesses through restructuring and reorganization in order to eradicate archaic ways of doing business. Outside of the above, the business proactive initiatives facilitating foreign investments would set the stage for growth of M&A deals in the country not only in volume but also by value.

On a concluding note, we fairly attribute that the headwinds in investment activities through mergers and acquisitions to be favourable in the years to come. The expectant efforts of the government may also be seen as another reason favouring acquisition activities.
As we move into the next year, more surprises await. The startup ecosystem poise limitless opportunities.

Important Legal Aspects To Consider While Exploring M&A Transactions In India And Ways To Streamline Its Process

In this era of rise in corporate frauds and overnight bankruptcy cases, the indispensable aspect prior to negotiating any mergers and acquisition transaction is an efficient due diligence activity. Therefore, more often than not diligence is termed as a 'measure of prudence' which can rock the sails of any transaction towards a prudent direction.

However, diligence is not the basis but only a facilitator to undertake any M&A transactions in India. Apart from the diligence exercise, the degree of corporate governance exercised by the entities in their ordinary business course is another vital tool to measure the synergies of any M&A deal. This age is the age of technology and its effective integration would set a forward-looking path in our continuous endeavour to streamline the process of M&A activities.

Moreover, the most recent initiative by the government to expedite M&A's is the process of deemed approval under Green Channel Route by the Competition Commission of India for certain categories of M&A's. These initiatives of the government, has led India to move 14 places up at 63rd rank in 'Ease of Doing Business' rankings by the World Bank.

M&A with reference to Competition Act
The competition act, 2002 was enacted with an objective of promoting competition and protecting the interest of consumers. The article will begin with the study of the evolution of the MRTP act and will analyze the loopholes in the act that led to the passing of the competition act. The article will mainly focus on the concept of merger and will also lay emphasis on the factors that has led in the increase of this business arrangement so extensively. The article will also discuss several kinds of merger. The article will profoundly analyse the role of the competition commission of India and the powers conferred upon it in regard to combinations under the act. The article will also make comparative analysis of merger under the European Union and the Indian competition Act. The main motive of the author behind writing this article is to make an easy understanding of the concept of merger and how it is regulated by the competition commission.

The Study of Merger And The Role of Competition Commission of India.

Evolution of MRTP ACT, 1969
The word socialist was added in the Indian constitution by the 42nd amendment. The main objective behind inclusion of the word in the preamble was to eliminate all the discriminations leading to inequality in income, status and standard of life. In pursuant of this objective the government was against concentration of economic power in few hands which may adversely affect the interest of weaker sections. In pursuance of the recommendation made by the monopolies inquiry commission a bill pertaining to

monopolies and restrictive trade practices was presented before the parliament and the same act came into effect in the year 1969. The constitution of India through its article 38 and 39 strives to promote the welfare of people by securing and protecting as effectively as it may, a social order in which justice – social economic and political shall inform all institutions of national life that the ownership and control of material resources of the community are so distributed as best to serve the common good. The MRTP act derives its inspiration from these constitutional provisions.

Objectives of MRTP Act

Ø Prevention of concentration of economic wealth in few hands which prejudicially affects the interest of others.
Ø To put control over monopolies
Ø Prohibition of restrictive trade practices
Ø Prohibition of monopolistic trade practices
Ø Prohibition of unfair trade practices.

Evolution of Modern Competition Law

The factors which led to the passing of MRTP act underwent tremendous changes which led to the framing of new competition Act. After the passing of the new act the policies of the Government of India changed from command and control to liberalisation and globalisation of trade. MRTP Act was considered to be the competition Law of India because it was mainly concerned with restraining any trade practices which have the effect of preventing or restraining competition. But with the passage of the time it was realized that MRTP Act of the country was a weaker legislation on competition in comparison to the competition Law of other countries.

Then Finance Minister of India in his Budget Speech on 27th February, 1999 stated that:
"The Monopolies and Restrictive Trade Practices Act has become obsolete in certain areas in the light of international economic developments relating to competition laws. We need to shift our focus from curbing monopolies to promoting competition. The Government has decided to appoint a commission to examine this range of issues and propose a modern competition law suitable for our conditions".

A high Level committee on Competition Policy and law was constituted by the Government of India known as Raghavan Committee for examining various aspects and give suggestions to the government regarding the competition policy. Raghavan Committee report on Competition Law observed as follows:-
'The absence of domestic competition, along with the unconditional protection from imports provided to domestic industry together with the other aspects of the licensing regime discussed above, fostered a high cost industrial structure which was domestically inefficient in the utilization of resources and not competitive abroad. In addition to the static mis- allocation and inefficient utilization of recourses, the system was also dynamically inefficient insofar as it was not likely to encourage technical change. On the other hand, a competitive market structure with right prices would have promoted a dynamic, efficient, productive and competitive industrial sector. Competitive financial sectors ensure better utilization of scare financial resources and have had a positive impact on the productivity of industrial sector".

In India, the MRTP Act was enacted in 1969 and was mainly concerned with the control of monopolies and prohibition of monopolistic and restrictive trade practices, not on fostering competition or protecting the interest of the consumer. This led to the passing of competition Act, 2002 that came into effect in the year 2003.

A broad definition of competition is- "situations in a market in which firms or sellers independently strive for the buyers' patronage in order to achieve a particular business objective for example, profits, sales, or market share" (World Bank, 1999).

Regulation of Combinations

The Competition Act, 2002 (as amended), is mainly concerned with promoting competition and providing protection to the Indian market by prohibiting any practices causing appreciable adverse effect. The act is mainly concerned with prohibiting three kinds of agreement that includes anti-competitive agreements, abuse of dominant position and the regulation of combinations (mergers and acquisitions). A combination is not void per se but if CCI is of prima facie opinion that the outcome of such transaction may results in appreciable adverse effect on competition (AAEC), then the CCI may issue a show cause notice to the parties under Section 29(1) of the Act to ask such parties to the combination as to why no investigation should be carried against them.

Section 5 of the act defines combination and the provision pertaining to the regulation of the combination is contained in section 6 of the act. The competition commission of India is conferred with several powers under the act. Section 7 of the act provides provision for the constitution of the commission under the Act. Under section 29 of the Act the commission is empowered to conduct investigation into any combinations having detrimental effect on the competition in the market. There are certain orders which can be passed by the commission under Section 31 of the Act.

The competition commission Act also contains provisions pertaining to the establishment of Competition Appellate Tribunal under section 53A of the act. Any person aggrieved by the decision of the commission may appeal before the Appellate Tribunal.

Mergers And Acquisitions (Combinations) Under The Competition Act, 2002

In the last few decades the process of globalisation and liberalisation has rapidly changed. In the quest of this globalisation, there was liberalisation of the Indian economy which took place in the year 1991. The globalisation of the economy resulted in increasing the competition within and outside the Indian market. There has been rapid increase in cross-border merger and acquisitions activities of the Indian companies. The situation became so alarming that the immediate need was felt to prevent activities which was detrimental to the competition and which caused appreciable adverse effect in the market. The competition Act, 2002 was enacted with an objective for promoting competition and protecting the interest of the consumer. The competition act, 2002 mainly deals with three kinds of agreements like anti-competitive agreement, abuse of dominance and regulation of combination.

Before discussing about combination, it is necessary to throw some light on the two important provisions contained under the competition act which is related to anti-competitive agreement and abuse of dominance. Section 3 of the competition act prohibits from entering into any kind of arrangement pertaining to production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or are likely to cause an 'appreciable adverse effect on competition'' in India.

Section 4 of the act contains provision pertaining to abuse of dominant position by an enterprise. Under the monopolies act, a threshold of 25% was constituted as apposition of strength in the market. But this threshold limit does not find any place under the competition act. Competition act for the purpose of determining the abuse of dominant position is mainly concerned with the relevant geographic market and the relevant product market.

Section 6 is considered to be a vital provision pertaining to combination. This section provides provision for the regulation of combination. Under this section the competitions act restrains from entering into any agreement that cause or are likely to cause an appreciable adverse effect on competition within the relevant market in India.

Combination under Competition Act

Section: 5 of the Act provide the definition of the term combinations. It states that:

The acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be a combination of such enterprises and persons or enterprises, if-

1. If the parties to the acquisition acquire control over the voting rights, or control the shares or assets of the enterprise and the value of the asset is more than rupees one thousand crores or the turnover is more than rupees three thousand crores or where the value of the asset in or outside India is more than five hundred million US dollars.

2. Combinations also takes place when any group acquires an enterprise and control the shares, voting rights and assets of the enterprise in India where the value of the asset is more than four thousand crores or the turnover is more than twelve thousand crores, or when the aggregate value of the asset is two billion US dollar in or outside India.

3. Combination also takes place when a person acquires control over an enterprise and directly or indirectly exercises control over another enterprises engaged in production, distribution, or trading of a similar or identical or substitutable services.

4. Combination is also considered to take place when the value of the asset of the enterprise after amalgamation or merger is more than rupees one thousand crores, or when the aggregate value of the asset within or outside India is more than five hundred million US dollars.

5. Where the group after merger or amalgamation would belong to the enterprise and it would have the assets of the value of more than rupees four thousand crores or the aggregate value of the assets is more than two billion US dollar within or outside India.

Mergers under the Competition Act

The term Merger has been used broadly in the competition act as to include amalgamation and acquisition of shares and control over the assets and the voting rights of an enterprise. Merger is a kind of event which brings tremendous change in the management of the affairs of one enterprise by another enterprise.

Through merger one enterprise is entitled to exercise control over the significant part of the assets and the decision making power of the other enterprise. Merger is an ordinary activity which takes place between the business entities in order to expand their business.

Merger is considered to be a significant activity for the enterprise as it provides the enterprises to run their business on a large scale.

But there are certain mergers which are considered detrimental and adversely affect the competition. The most negative impact of merger is that it leads to the reduction of competition in the market by reducing the number of entities in the market. Merger between entities also leads to the increase in price of the goods and services which prejudicially affects the interest of consumers as the merged enterprises exercises full control over the market and restrain the entry of new players in the market which confers on them the advantage of limiting the output and restricting market access.

Kinds of Merger

Ø **Horizontal merger –**This type of merger takes place between the enterprises that are engaged in the trading of similar goods and services. It mainly takes place to improve the market share and to carry out the operations of the enterprises on a large scale. This kind of merger has an adverse affect on the competition as it creates collaboration between the enterprises pertaining to pricing of the good and limiting the output.

Ø Vertical Merger -Vertical merger is a kind of merger in which enterprises are engaged in different stages or levels of production chain in different markets, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services.

Ø Conglomerate Merger - Conglomerate merger is a kind of merger where two enterprises that merge together are involved in different kind of business. The significance of conglomerate merger is that it helps the merging companies to enhance their activities and strengthen their financial position. There are two kinds of conglomerate merger, the first one is known as pure conglomerate merger which basically takes place between the companies who are doing business which is not related to each other. The other kind of conglomerate merger is known as mixed merger which is a kind of merger in which the main object of the enterprises are to expand their business and to gain market access and to increase the range of their products.

Reason behind Mergers and Acquisitions

In the recent years mergers between the enterprises has rapidly increased. The point listed below discusses the main reason behind increased mergers taking place:

i) Market share- Companies amalgamate to reduce competition and to gain dominant position in the market. The increase in the market share helps the enterprises in exercising their will and limiting the production and increasing the prices.

ii) Large economy- One of the most important significance of merger is that the scales of the business entities are enlarged and they carry operations on a large scale which in turn leads to the generation of huge amount of revenue.

iii) Diversification- Diversification leads to the increase in the trust of the consumers as diversification yields fruitful earnings for the companies.

iv) Tax consequences- Companies amalgamate to evade tax. So it is one of the major factors which are considered while granting the order to merge as tax evasion creates loss of revenue to the government and prejudicially affects the economic development of the country.

MRTP Act, 1969 Vis-À-Vis Competition Act (Combinations Provisions)

In the MRTP act, 1969 there was a requirement to obtain assent from the central government before entering into any merger or amalgamation between the enterprises. Howsoever this provision was deleted in the MRTP (amendment) Act, 1991. But the competition act, 2002 has made it obligatory for every enterprise to give a notice of such merger between the enterprises.

Under MRTP Act, power was vested in the central government whereas in the competition act the power for regulation of the combination is vested in the commission constituted under the act and is known as the competition commission. The concept of asset or turnover outside India is a new concept and is implicit in the competition act but it had no place under the MRTP act. The concept of cross border merger was also introduced for the first time in the competition act, 2002.

Merger Control Vis-À-Vis European Union and India

Merger takes place when two enterprises join hands for better and efficient functioning of their business enterprises. Merger is a common practice which prevails among the business entities. Different enterprise has different objective behind merger like reducing the output or raise objection to the merger.[18] The government may reject the merger on the ground that it is against the industrial or foreign policy which may yield adverse effect on the competition as it may lead to the production of illegal quality or quantity of a particular product of illegal quality or quantity of a particular product.

Market players may raise objection against the merger as the merger result in anti-competitive practices merger restricts the entry of the new player in the market which increases the monopoly practices by the enterprises. Shareholders may also object if the merger is prejudicially affecting their interest. Similarly, individuals could oppose to a merger if the merger between the enterprises results in the increase of the price, reduction in the equality of the goods or other analogous practices.

Hence, it can be said that merger apart from creating efficiency causes appreciable adverse effect on the competition and henceforth merger control is required. Merger control is based on the preventive theory and generally operates ex ante, i.e. to prevent a transaction adversely affecting competition, before it is put into practice. The cost of de-merging entities after the merger transaction is very heavy and not an easy operation for competition and other regulatory authorities.

There has been rapid increase in the International trade and commercial activities. Cross-border transaction has increased rapidly with the growth of globalisation and liberalisation of trade. It has become vital for the nations engaged in cross-border merger to evolve a law for regulating merger and to be in consonance with the international trade community for nation states to have merger laws which are in concord with the international trade community.

Merger Control under European Commission

On May 1st 2004 a new Merger Regulation was adopted by European Commission replacing the old EU merger regulation of 1990.EU Merger Regulation of 1990 prohibits the mergers that: “create or strengthen a dominant position as a result of which effective competition would be significantly impeded ”. The old substantive test basically has two interpretations. Firstly it states that concentration is prohibited if there is a creation of dominant position. Secondly it states that if the effect of change is such that it amounts to significant impediment of effective competition (SIEC). The Merger regulation adopted on May 2004 reformulated the substantive test and it states as follows: - "A concentration which would significantly impede effective competition, in particular by the creation or strengthening of a dominant position, in the common market or in a substantial part of it shall be declared incompatible with the common market”.

Several critics has criticised this dominance based test. The definition of dominance was laid down by European court Of Justice in United Brands v Commission. The Court stated that: “The dominant position thus referred to (by Article [82]) relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.” The court stated that the concept of acting independently does not empower to make discrimination between dominant and non-dominant firms. Arguably the concept of "acting independently” does not provide an adequate basis for discriminating between dominant firms and non -dominant firms.

The court also stated that the enterprises are not at discretion to increase the prices without considering the customers or consumers. There are several advantages attached to merger, it helps in the expansion of business and develop new products. In Air France the CFI found that: “… the Commission is bound to declare a concentration compatible … where two conditions are fulfilled,

[1] the transaction … should neither create nor strengthen a dominant position and
[2] competition … must not be significantly impeded by the creation or strengthening of such position”.

Dominance is an important criterion for SIEC, so the court argued that “If therefore, there is no creation or strengthening of a dominant position, the transaction must be authorised, without there being any need to examine the effects of the transaction on effective competition”. The court stated that if there is no creation of dominant position, such kind of transactions must be authorised.

New SIEC Test
The new SIEC does not consider dominance either necessary or sufficient. It was contended that that the old SIEC test leads to under-enforcement. It was stated that the merger may have anti-competitive effects even in the absence of dominance; it was argued that making dominance as one of the most important criteria the old test offered no legal basis to challenge anti-competitive agreement.

Need For Adopting the New Test
There are two views to justify the need for then adoption of new test. The old two-tier test was incapable to address the perceived problems, such as the gap or the incorporation of efficiencies. The adoption of new test was needed to make it clear that what kinds of mergers are prohibited under the Act so that those kinds of mergers are not attempted.

The second view is that the new test makes a difference in the analysis of mergers itself. Dominance is mainly concerned with market power of the merged entity and ignoring these equilibrium effects may lead to significant errors. There are several benefits of the new merger regime and the new test should increase merger control effectiveness. The benefits can be classified into two categories.

a) Less false negatives: The main justification for reformulating the test is to eliminate the requirement to show dominance to challenge a merger. It reduces the anti-competitive mergers. Expected benefits can be classified into less false negatives (under enforcement) and less false positives (over-enforcement).

b) less false positives- The new test focuses on the merger-induced changes to the competitive environment, not on whether the merged entity reaches an intolerable level of market power.
By eliminating dominance as a necessary condition the new test focuses more directly on the principal economic question raised by a merger, namely whether competition is likely to be reduced.

Merger Control in India
Though the competition act came into force in the year 2003 but the provisions pertaining to anti-competitive agreements, abuse of dominant position came into effect in the year 2009. In the year 2011 proposal for the amendment to the provisions to the merger control was made by cci after consulting law firms, business entities and the stake holders.
In India Merger as a part of the combinations has been defined in section 5 of the competition act and the provisions relating to the regulation of the combination is defined in section 6 of the Act. Merger is an ordinary practice in the business world. It has several advantages like increasing efficiency and economy but there are several detrimental effects of merger. The effects are so severe that there was need felt to control merger.

Any merger is considered to be prejudicial if it causes "Appreciable Adverse Effect" on competition. The term appreciable adverse effect has not been defined in the Competition act but any kind of merger having this effect is prohibited under the competition act. Section 20(4) of the Competition Act, 2002 provides the substantive test whether the combination has or is likely to have ―appreciable adverse effect on combination -. The substantive test encompasses examination of certain factors incorporated in the above section.

Some of the factors are:

a) Restraining entry of new players in the market
b) Advantage of the combination to the economy of the country
c) Extent of elimination of competition from the market.
d) The availability of substitutes in the market.
e) Whether the benefits of combination outweighs the adverse effect on competition.

Analysis of the Role of Competition Commission
Competition commission of India is a significant body of the Government of India. It is accountable for the enforcement of the competition act, 2002. Competition Commission plays an imperative role in preventing adverse effect on competition in India. Competition commission acts as a market regulator of all the sectors and primarily draws

focus on curbing the anti-competitive practices which is detrimental to the competition. Competition Commission of India is empowered to take cognizance of the anti-competitive practices prevailing in the Indian market. The Competition commission was established on 14 October and came into effect on May 2009.

Duties of Competition Commission

Competition commission has been entrusted with several duties under the competition act 2002. The primary duties of the competition commission are:

- To eliminate practices having appreciable adverse affect on competition
- To maintain competition in the market.
- To promote freedom of trade and eliminate any constraints in the entry in the market.
- To protect the interest of the consumers and to eliminate all the practices prejudicially affecting the interest of the consumers.
- To persuade new entities to enter in the market for producing better quality of good and delivering better services.
- Competition commission is also required to give its opinions on vital matters affecting competition or any reference made to it by the statutory authority.
- It is also the duty of the competition commission to create consciousness among the public and impart training facilities on competition issues.

Section 18 of the competition act deals with the duties of the competition commission of India.

Power of the competition commission

There are several Powers conferred on the competition commission:

- It has the power to regulate its own procedure
- The commission has the power to call upon and take assistance from experts from various fields like field of economics accountancy and commerce etc. in the conduct of any inquiry it undertakes.
- In the discharge of its functions competition commission is required to follow the principle of natural justice and should comply with the provisions of the competition act 2002.

Power of Competition Commission In Regard To Combination Under The Competition Act

There are certain powers conferred on the competition commission for regulating combination.section-6 of the competition act deals with the provision pertaining to regulation of combination. It states that no person should enter into any combination which is likely to cause appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

1. Mandatory Notice-

It is obligatory for any enterprises entering into any combination to notify the competition commission about the merger if the value of the aggregate assets and turnover exceeds the threshold limit provided under section 5 of the act. The required notice should be forwarded to the commission within a period of 30 days.

2. 210-Days Waiting Period-

under the competition act it is provided that no combination will come into effect until 210 days have elapsed since the date of receiving the notice pertaining to combination by the commission or the date of passing of the order whichever is earlier.

3. Relevant Market-

Relevant market means 'the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets'. Relevant geographic market means 'a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and may be distinguished from the conditions prevailing in the neighboring areas. Relevant product market means 'a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use.

1) Form Filing and Cost-

There are certain forms which are prescribed by the competition commission to be filed with notice of the combinations. The competition commission is also empowered to issue show cause notice to the parties of combinations if the commission is of the opinion that such combination if allowed will cause appreciable adverse effect on the competition.

2) Extra-Territorial Jurisdiction-

Section 32 of the competition act confers an imperative power on the commission to inquire into any act pertaining to any agreement, abuse of dominant position or combination taking place outside India but adversely affecting the competition in India. In the Indian Competition Act, 2002 has the extra territorial jurisdiction.

Determination of Appreciable Adverse Effect on Competition

Appreciable adverse effect on competition is on significant factor for the regulation of the combination. The competition act has empowered the commission to evaluate the effect of combinations. There are certain factors that are considered by the competition commission while evaluating the effect of combination on the competition in the market. The factors for the regulation of the combination are contained in section -20(4) of the act.

The relevant factors are:

a. The actual competition that prevails in the market through imports in the market.
b. The availability of the substitutes in the market
c. Degree of countervailing power in the market
d. The market share of the enterprises entering into combination in the relevant market.
e. Likelihood that competition will eliminate competitors from the market and reduce competition.
f. Likelihood that the combination would result in the rise of prices and limiting the output.
g. Restraining the entry of new players in the market.
h. Possibility of failing of business
i. Advantages to the economy of the country

j. Nature and extent of vertical integration in the market.

k. Whether the benefits of the combination outweigh the adverse impact on combination.

Investigation of Combinations

The Competition Commission after receiving the notice of proposal pertaining to combination forms prima facie opinion that such combination is likely to or has caused appreciable adverse effect on the competition within the relevant market in India, the commission is under such circumstances empowered to issue show cause to the parties to the combination asking them to respond within a period of thirty days as to why the investigation should not be initiated against them.

The competition commission after receiving the report from the Director General or the response of the show cause notice by the parties whichever is later may issue direction to the parties to publish details of the combination within ten working days of such direction for informing the public and for inviting any objection raised by any person whose interest will be affected by such combination. The commission invites written objection from any aggrieved person or any person who is likely to be aggrieved to submit his objection within fifteen working days from the date on which the details of the combination were published.

The commission on the expiry of fifteen days may call for additional information and such additional information is required to be furnished by the parties within a period of fifteen days from the expiry of the period. The commission may after receiving all the information and within a period of forty five working days from the expiry of the period proceeds to pass orders.

Orders Passed By the Commission

The commission after conducting inquiry and investigation is of the opinion that any combination regarding which the notice has been forwarded to the commission does not have any adverse effect on the competition and it does not injures the interest of the consumer , in such circumstances the competition commission has the authority to approve such combination. Under the competition act combination is permissible but it is subject t o the condition that it does not defeat the purpose of the act that is to maintain competition and protect the interest of the consumer.

If after the completion of the required inquiry into the combination the commission forms an opinion that such combination are likely to cause appreciable adverse effect on the competition it may issue an order of restraining such combination. Circumstances may exist where commission is of the opinion that the combination can cause appreciable adverse effect on the competition but such adverse effect can be eliminated through certain modifications. So the commission is empowered to issue an order pertaining to modification in such combination.

The modification proposed by the competition commission should be carried out by the parties to the combination within a specified period as granted by the commission. In case of the failure of the parties to carry out the order, the commission treats such combination as a combination causing adverse appreciable effect on the competition and deals with such combination according to the provisions of the competition act.

In case the modifications proposed by the competition commission are not acceptable by the parties to the combination, in this situation the parties are empowered to propose certain amendments to the modification. If the amendments to the modifications are accepted by the competition commission, then it approves such combination and if such amendments are rejected by the commission then the parties are granted further 30 days to incorporate such modification in combination proposal.

If the parties fail to comply with the order of the commission, then the commission treats such combination as causing adverse effect on the competition. The provisions related to orders of commission on certain combination are contained in section-31 of the Competition act.

Power to Impose Penalty

The competition commission is also empowered under the act after conducting inquiry into the matter pertaining to combination to impose a fine that can be extended to one percent of the total turnover or the assets of the combination, whichever is higher, for failure to give notice to the commission of the combination.

Appeals

The central government is empowered under the act to constitute Competition Commission Appellate Tribunal to hear any appeal or any direction issued or decision made by the competition commission under any provision of the act including any order related to combination. An appeal before the competition commission appellate tribunal is required to be filed within a period of 60 days after the passing of order or decision by the competition commission.

Conclusion

Combinations are the practices common to the business entities and the purpose of the combination is to accelerate economic growth and enhance trade practices which in turns benefit the consumers.

Combinations are not always beneficial and might cause socio-economic implications on the competition as today's competition may be tomorrow's dominance. Before the enactment of the Competition Act, the Companies Act, 1956, MRTP Act, 1969 were the statutes mainly concerned with the regulation of merger.

MRTP before its amendment which took place in the year 1991 had power to control restrictive trade practices (RTP) and monopolistic trade practices (MRTP) and was empowered to take action against any merger that has appreciable adverse effect on the competition. But after the amendment of MRTP Act which took place in the year 1991 for the liberalisation of trade resulted in the incompetence of the MRTP Act to control the unfair mergers.

For the purpose of promoting fair trade practices and prohibiting any kind of practices which are detrimental to the competition, the competition act, 2002 was enacted. Competition laws of India underwent two amendments which took place in the year 2007 and 2012. These amendments had an imperative impact on the provisions of the merger under the competition act. By 2007 amendment the notification in regard to the combinations i.e. (Mergers, Acquisitions & Amalgamations) to the commission was made compulsory under the act. There was an increase in the combination limit by the 2012 amendment of the competition act which was a kind of relief for several kinds of merger.

The competition commission of India enjoys enormous power under the act. The main duty of the commission is to eliminate any adverse practices which are detrimental to the interest of the consumers. It is also empowered to conduct investigation if he forms a prima facie opinion that the combination is or are likely to cause appreciable adverse effect on the competition. It may also pass several orders for different mergers after considering several factors. It is also empowered to impose penalty which can exceed 1% of the total turnover or assets of the combination.

Henceforth it can be concluded that Merger has both positive and negative effect. In order to ascertain the true nature of merger it is necessary to study the objectives behind merger.

Demerger, LBO & MBO

Demerger

Demerger is a disjoining or a separation of one or more units of a company to form a new company independent from the original one. The following definition of demerger is excerpted from section 2 (19AA) of Income Tax Act, 1961-

"Demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 (1 of 1956), by a demerged company of its one or more undertakings to any resulting company"

Demerger is the business strategy wherein company transfers one or more of its business undertakings to another company. In other words, when a company splits off its existing business activities into several components, with the intent to form a new company that operates on its own or sell or dissolve the unit so separated, is called a demerger.

A demerged company is said to be one whose undertakings are transferred to the other company, and the company to which the undertakings are transferred is called the resulting company. The demerger can take place in any of the following forms:

1. Spin-off
2. Split-up

Spin-off

It is the divestiture strategy wherein the company's division or undertaking is separated as an independent company. Once the undertakings are spun-off, both the parent company and the resulting company act as a separate corporate entities.

Generally, the spin-off strategy is adopted when the company wants to dispose of the non-core assets or feels that the potential of the business unit can be well explored when operating under the independent management structure and possibly attracting more outside investments.

Wipro's information technology division is the best example of spin-off, which got separated from its parent company long back in 1980's.

Split-up

A business strategy wherein a company splits-up into one or more independent companies, such that the parent company ceases to exist. Once the company is split into separate entities, the shares of the parent company is exchanged for the shares in the new company and are distributed in the same proportion as held in the original company, depending on the situation.

The company may go for a split-up if the government mandates it, in order to curtail the monopoly practices. Also, if the company has several business lines and the management is not able to control all at the same time, may separate it to focus on the core business activity.

Reasons for Demerger of companies

There are many reasons for a company to undergo the demerger process. Some of them are:

- **Dismantling of conglomerates**
  Historically, demergers were used as a tool to dismantle conglomerates as running such organizational structures was a hefty task and proved that the cost outweighed the benefits reaped in the economic environment. Dismantling conglomerates was based on the idea to eliminate the inefficient organizational structures and reducing the negative synergies.

- **Compliance with rules and regulations**
  The action may be necessary in order to comply with the rules and regulations of the local territory in which the company wishes to establish. If the regulations laid down by the authority state that the company needs to emerge before establishing itself in the country then the company has to emerge in order to operate in that country.

- **Focus on core business**
  Companies which own more than one business and the smaller one is not recognized in the valuations of these companies the demerger maybe a way to separate these investments out of the core business. This way more focus and resources will be diverted to the core business and productivity can be increased. With the help of demerger, companies can become more flexible and venture into other growth opportunities.

- **Attract investors**
  A demerger generates cash which can be used by the parent company to pay off its debt. This way a demerger can save a lot of interest on debt and also increase the cash flow to the equity holders. The prospect of receiving a higher dividend increases the share price of the parent company. Demerger attracts new investors which have an interest in particular sectors.

Example: Pantaloon which is a retail brand was only attracting retail investors, by spinning off a private equity fund, Kshitij it attracted investors of a different sector.

- **A tool for value creation for shareholders**
  It is true that with the help of demerger, the company is able to focus on its core goal of each business which can be reflected in the increasing valuation of the company in the market.

  Example: Dabur India demerger which comprised of the FMCG business included personal care, ayurvedic and healthcare products. They have a pharmaceutical wing which includes allopathic, oncology and other drugs. The main reason for this demerger was to establish a global presence in the pharmaceutical industry.

  Historical data of recent years suggests that the demergers have resulted in significant value unlocking for both parent and demerged entities.

TWO IS BETTER THAN ONE

Demerged company	Date of listing of demerged company	Returns (%)*	Parent	Returns (%)*
Zuari Agro Chemicals	Nov 27, 12	-39	Zuari Global	-21
NRB Industrial Bearings	Apr 15, 13	662	NRB Bearings	297
Orient Cement	Jul 12, 13	212	Orient Paper & Industries	229
Future Lifestyle Fashions	Oct 1, 13	-52	Future Retail	36
Star Ferro & Cement	Oct 24, 13	547	Century Plyboards (India)	722
Jindal Poly Inv. & Fin.	Nov 11, 13	-29	Jindal Poly Films	29
Marico Kaya Enterprises	Jul 2, 14	574	Marico	57
Welspun Enterprises	Jul 11, 14	313	Welspun Corp	-36
Gulf Oil Lubricants India	Jul 31, 14	112	Gulf Oil Corporation	-4
Intellect Design Arena	Dec 18, 14	48	Polaris Financial Technology	43
Greenlam Industries	Mar 2, 15	-4	Greenply Industries	-1

Over the past few years, companies that have been listed after the demerger from their parent companies have created handsome returns for investors. Of the top eleven demerged entities by market cap, six of them have given returns of 112-662 per cent, one has risen 48 per cent and four have fallen by four to 52 per cent.

Stocks like NRB Industrial Bearings, Orient Cement, Star Ferro and Cement, Marico Kaya, Welspun Enterprise and Gulf Oil Lubricants are leading performing demerged stocks. Intellect Design Arena, products business of information technology company Polaris, has yielded 48 per cent returns since listing on December 18, 2014. These companies were demerged for all the correct reasons, which have helped in considerable value creation.

- **Ability to leverage on an equity account**
  Companies when in a high growth phase need funding on an ongoing basis in order to expand their capacity and establish a global presence. There is a limitation on raising debt and also internal accruals for the company which can cause hindrance for expansions plans. Here demerger offers a solution as the company here can choose to dilute equity in only a particular business.

Demergers in the Indian legislature

The term demerger is not defined in the companies act, 2013. However, an explanation is given to *section 230(1)* of the said act prescribes it as an arrangement for the reorganization of the company's share capital by:

1. Consolidation of shares of different classes
2. Division of shares of different classes
3. Or both.

Demerger is defined under *Section 2(19AA) of the Income-Tax Act, 1961* in relation to companies can be defined as a transfer pursuant to the scheme of arrangement under *sections 391-394 of the companies act 1956(old act)* by a demerged company of its one or more undertakings to any resulting company in a manner by which:

- All the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger
- All the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger
- The property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger
- The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company
- The shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company
- The transfer of the undertaking is on a going concern basis
- The demerger is in accordance with the conditions, if any, notified under Income-Tax Act, 1961, s 72A(5) by the central government in this behalf.

Demerger allows a company to expand its operations in a very systematic manner. It allows a specific division or unit to grow as a separate and a focused entity, thereby increasing its efficiency and effectiveness. It benefits the shareholders by providing them better opportunities to participate in the management, operations, decision making process and profits of the applicant company as well as the resulting company.

Demerger can be affected by any of the following three ways:

1. Demerger by agreement between promoters; or
2. Demerger under the a scheme of arrangement with approval by the Court under section 391;
3. Demerger under voluntary winding up and power of liquidator.

Demerger by agreement between promoters

Demerger may take place by agreement between promoters of the demerging company. In such a scenario, the principle company may spin off its specific undertakings to the resulting company. All the property, liabilities and issues of the principle company, transferred to the resulting company immediately before the demerger, becomes the property, liabilities and issues of the resulting company.

Demerger under the a scheme of arrangement with approval by the Court under Section 391 of the Companies Act

In order to affect a demerger, there must be a provision in the Memorandum of understanding of the principle company. The scheme of such arrangement has to be submitted in the respective High Courts of the states where the head office of the principle as well as resulting company is registered.

The procedure for demerger by this method is as follows-

1. **Preparation of Scheme of Arrangement**
   The scheme of arrangement is prepared after consulting the interested parties and stakeholders. Such arrangement is approved by the board of directors. Also, the share exchange ratio is determined while balancing the interest of all the parties.

2. **Application to court for direction to hold meetings of Members/Creditors**
   The summons is issued under section 391 by a judge of the concerned High Court after an application is filed in Form 33 accompanied by an affidavit in support in Form 34. The scheme of such arrangement must also be annexed. Additional documents that are to be filed before the High Court are:
   a) Memorandum and articles of association of the Company;
   b) Latest Audited Balance Sheets ;
   c) List of Shareholders and Creditors;
   d) Extract of Board Resolution approving the Scheme, and
   e) Draft notice of Meeting, Explanatory Statements and Proxy.

3. **Obtaining court's order for holding meeting of Members/Creditors**
   The court examines the fairness of the scheme submitted by the applicants and subsequently issues summons in Form 35 of the Court Rules. The court has to ensure that the scheme is capable of being implemented.

4. **Notice of meeting of Members/Creditors**
   A notice in Form 36 is sent to the interested parties by the persons authorized by the courts at least twenty one days before the date of the meeting accompanied by the proposed scheme and proxy forms. Such notice shall also be advertised in Form 38 in such newspapers that are well circulated among the interested parties.

5. **Holding meeting of Members/Creditors**
   A meeting shall be held according to the directions of the court and the result of such meeting shall be decided by separately counting votes in favor and against the motion. The chairperson of each meeting shall submit a report in Form 39 within the time prescribed by the court.

6. **Petition to the Court for sanctioning the scheme of Demerger**
   A petition in Form 40 has to be submitted to the court for sanctioning the scheme of demerger. It has to be approved by three-fourths of members/creditors in order to file a petition to sanction the same.

7. **Court's order on petition sanctioning the scheme of Demerger**
   After hearing the objections, the Court may pass an order approving the scheme of scheme of demerger in the same newspaper in which the notice of meeting was advertised.

Demerger under voluntary winding up and power of liquidator
The original company which has split into several companies after division could be wound up voluntarily pursuant to the provisions of Sections 484 to 498 of the Companies Act, 1956. In such a situation, the company getting wound up may transfer or sell wholly or a part of its operations to another company.

The liquidator of the transferor company may, with the sanction of a special resolution of that company receive, by way of compensation or part compensation for the transfer or sale, shares, policies, or other like interests in the transferee company, for distribution among the members of the transferor company or any other purpose.

There are demergers in the public and the private sectors. The contemporaneous method to combat the present economic situation in India is being well dealt with the equipment of Demergers. In the private sector, the demerger of the Reliance group into Reliance Industries Ltd. and Anil Dhirubhai Ambani group is by far the biggest demerger witnessed in India. The public sector is also well abreast with this emerging idea of reconstruction.

Some of the live examples of Demergers cases which took place in India

1. **Demerger of Dabur India in July 2003** – FMCG group and Pharma group -beneficial for both the group –

After demerger FMCG Group registered a compounded annual sales growth of around 12 per cent over the past three years, with net sales of Rs 1,048.5 crore and net profit of Rs 72 crore in 2002-03. For The pharmacy business, on the other hand, net sales have doubled in three years . This division reported a net profit of Rs 13.1 crore on net sales of Rs 184 crore in 2002-03. Pharma Brand have already 20 % market share in oncology products and have also got various products for exporting to 27 countries.

The main reason for the demerger was to harmonise strategies, create operational efficiencies and maximize pharma's penetration into global market the main growth drivers during the fiscal were its globally expanded anti-cancer range of products and brands like Liv-fit, Ulgel, Honitus and Contrastin. There after Dabur Pharma have not looked behind – development came one by one by strategic alliance with Abbott Laboratories for generic oncology products in the United States, November 03, 2003.Followed by Dabur Pharma Acquiring Sales & Distribution Business in Thailand-January 09, 2007 , Agreement with Spanish market – Oct 2007 ,Launch of Irinotecan injection in Italy & Denmark -march 11 2008 and many more .

2. Reliance industries –Demerger- August 2005
Reliance Industries, which focuses on exploration and production (E&P), refining and retailing, and petrochemicals is under the chairmanship of Mukesh Ambani and his younger brother Anil took charge of businesses comprising Reliance Communication Ventures, Reliance Energy Ventures, Reliance Capital Ventures, and Reliance Natural

Resources. The reason probably was rift between brothers but the move has benefited both. Earlier Reliance was basically into industrial products but now with demerger it has entered into other segments like reliance telecommunication with a vision to bring mobile communication to post card cost .
And other privates are fighting back to break the image which Reliance mobile have created in the mind of customers by the slogan “karlo Duniya Mutthi Me”. Even the newer entity under Anil Ambani is trying to tap the untapped food processing segment. Also RIL is making its way into retail industries by developing a model of promoting partnership with farmers ,logistics operations, small shopkeepers ,traders .The demergers have not affected Mukesh’ Petrochemical business and he gained the position of no 1 ranking business tycoon all over the world thereby defeating Bill gates .

Scheme of demerger
Reliance Industries Ltd unanimously approved the scheme of demerger of the business of the company in August 2005. The committee along with the advisors presented a scheme of demerger with the objective of unlocking the value of all shareholders, the board of directors and to examine in depth all the issues including statutory and legal requirements for the reorganization. The scheme of demerger was approved by the board, Mumbai high court, stock exchanges, and shareholders

The scheme had proposed to demerge assets and liabilities into the following undertakings:

1. Telecommunications undertaking
2. Coal-based energy undertaking
3. Financial services undertaking
4. Gas based energy undertaking

Benefits to shareholders
From the demerger of Reliance Industries the shareholders would be benefited in the following ways:

- The shareholders of the company participated in the growth and progress of the company by holding the same shares in the global oil, gas, refining and Petrochemicals Company as they held in the current company
- They would also receive separate shares in the demerged entities, which would allow them to participate separately as well as collectively in the growth areas of the demerged entities.
- Also, the shares of the resulting companies will be listed on the stock exchanges where the shares of the company are currently listed which will provide liquidity to all shareholders.
- The shareholders can participate directly in all the businesses which will unlock value and provide growth aspects.

3. Demerger of L & T cement division to a new entity CEMCO.
The demerger process need to take place in 3 steps .

- In the Ist phase L&T would hive off the cement business into a separate company, Ultra Tech CemCo, where it will hold 20 per cent. The balance 80 per cent will be held by the existing L&T shareholders proportionately.
- In the second phase, Grasim will buy 8.5 per cent in CemCo from L&T at Rs. 342.60 per share and make an open offer for another 30 per cent at the same price.

If fully subscribed, the open offer will make the Aditya Birla group's holding in CemCo to 51 per cent and L&T will realize Rs. 362 crores on sale of its stake in Ultra Tech CemCo.

- In the third step, L&T Employee Welfare Foundation will acquire the Birla's 15.3 per cent stake in the residual engineering company.

4). Wipro

Another recent example of demerger would be of Wipro which declared its scheme of demerger would be effective from 31st March 2013. Wipro declared to demerge its non-IT business into a separate unlisted company called Wipro Enterprises. The reason for this demerger was aimed at creating a separate company out of Wipro’s customer care, lighting, furniture, hydraulics, water, and medical diagnostic product business. By separating the entities Wipro can focus exclusively on its IT sector. The resulting company is a private limited company which does not have any shares listed on the stock exchange.

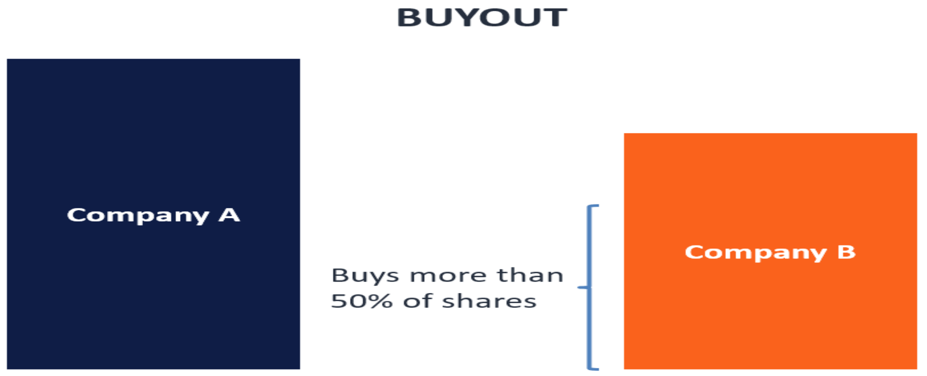
The 3 units which have demerged into one separate entity provided for 14 percent of the total revenue for the company whereas the IT business contributed to the rest 86 percent. By this demerger, Wipro would be able to focus more on the IT business and accelerate revenue.

Various other demergers have taken a row

- Great Eastern Shipping, which is demerging its offshore business;
- Eveready Industries separated its tea business into McLeod Russell;
- Auto ancillary company Rane Madras transferred its investments into separate company and the investment company was also listed.
- The demerger list also includes Vardhman Spinning and Morarjee Realities.
- Also demergers of Bajaj Auto group are on the process.
- Gabriel India is also looking at demerging its engine bearings division and may also sell its Mumbai property.
- Cairn India on the reorganization of Cairn Energy PLC's Indian business prior to flotation.

Buyout

A buyout refers to an investment transaction where one party acquires control of a company, either through an outright purchase or by obtaining a controlling equity interest (at least 51% of the company’s voting shares). Usually, a buyout also includes the purchase of the target’s outstanding debt, which is also known as assumed debt by the acquirer.



The transaction often takes place in situations where the purchaser considers a firm to be undervalued or underperforming, with potential for improving operationally and financially under new ownership and control. Like any other investment, a buyout will take place when an acquiring party sees that there is an opportunity of making a good return on their investment. A buyout offer may be one of the main goals of a business owner, or an unforeseen opportunity that arises.

The Buyout Process

The buyout process typically commences when an interested acquirer formally makes a buyout offer to the board of directors of the target company, who represent the shareholders of the company. Negotiations will then ensue, after which the board of directors will provide insight to shareholders on
whether to sell their shares or not.

The money to be used in buyout transactions is usually supplied by private individuals, companies, private equity firms, lenders, pension funds and other institutions. Buyout firms focus on facilitating and funding buyouts and may do so with others in a deal or alone. Such firms normally acquire their money from wealthy individuals, loans, or institutional investors.

Types of Buyouts

1. Management Buyouts (MBO)

A management buyout occurs when the existing management team of a company acquires all or a significant part of the company from the private owners or the parent company. An MBO is attractive to managers since they can expect greater potential rewards by being the owners of the business instead of employees.

An MBO is also a preferred exit strategy for private companies when the owners want to go into retirement, or for large organizations that want to sell some divisions that aren't part of their core business. The transaction often requires substantial financing, which is normally a combination of equity and debt.

2. Leveraged Buyout (LBO)

A leveraged buyout occurs when the purchaser uses a huge loan to gain control of another company, with the assets of the firm under acquisition often acting as collateral for the loan. Leveraged buyouts allow purchasers to acquire large companies without the need to commit huge amounts of capital. CFI has an applied LBO Modeling Course, which covers how to build a Leveraged Buyout model from scratch.

Advantages of Buyouts

1. **More Efficiency**
   A buyout may get rid of any areas of service or product duplication in businesses. It can reduce operational expenses, which in turn can lead to an increase in profits. The business taking part in the buyout can do a comparison of individual processes and select the one that is better. The company that is formed may be in a better position to acquire insurance, products, and other things at better prices.

2. **Reduced Competition**
   A business can increase its profits by buying its competition. The buyout can offer the newly formed company increased economies of scale, as well as eliminate the need to get into a price war with a competitor. That may lead to reduced prices for the products or services of the company, which will be beneficial to its customers.

3. **New Technology or New Products**
   A big and established company may want to buy a smaller company with a new technology or a promising product, a move that will benefit both companies. The smaller company that is being bought will benefit by getting access to better and more resources, as well as the opportunity to offer its technology or products to a larger customer base.
   The larger company benefits by incorporating the new technology or products of the smaller company into its current product line, without the need to pay to license the technology.

Disadvantages of a Company Buyout

1. **Increase in Debt**
   The acquiring company may need to borrow money to finance the purchase of the new company. This move will affect the debt structure of the acquirer and lead to an increase in loan payments on the company's books. It may force the company to cut back on their expenses elsewhere. For instance, they may be required to lay off some employees or even end up selling a part of their business so as ensure they remain profitable. Moreover, the funds used by the company for the business buyout takes money away from internal development projects.

2. **Loss of Key Personnel**
   Sometimes company buyouts may be regarded as a time for some of the key personnel to quit and retire or find a new challenge. Finding other personnel with equal experience and knowledge can be a tough challenge.

3. **Integration**
   Integration of the personnel and procedures of the two companies is going to take time. Even though the two companies may be doing comparable things, they may have significantly different corporate cultures and operational methods. This may result in a resistance to change within the company that can cause serious and costly problems. The result could be a loss in the company's productivity.

Summary
A buyout involves the process of gaining a controlling interest in another company, either through outright purchase or by obtaining a controlling equity interest. Buyouts typically occur because the acquirer has confidence that the assets of a company are undervalued.

Others may happen because the purchaser has a vision of gaining strategic and financial benefits such as new market entry, better operational efficiency, higher revenues, or less competition. Ultimately, most buyouts take place as a result of the purchaser's belief that the transaction will create more value for the shareholders of a company than what is possible under the target company's current management.

During a buyout, both sides will see advantages and disadvantages. There are several things that need to be taken into consideration to make the transaction successful. The agreement should ensure the needs of both parties are met. It is, however, unrealistic for both sides to achieve everything they desired. The pros and cons of the buyout need to be considered wisely on both sides.

Management Buy-out

A management buyout (MBO) is a corporate finance transaction where the management team of an operating company acquires the business by borrowing money to buy out the current owner(s). This transaction is a type of leveraged buyout (LBO) and can sometimes be referred to as a leveraged management buyout (LMBO).

In a MBO transaction the management team believes they can use their expertise to grow the business, improve its operations, and generate a return on their investment. These transactions typically occur when the owner-founder is looking to retire or a majority shareholder wants out.

Lenders often like financing management buyouts because they ensure continuity of the business' operations and executive management team. This transition often sits well with customers and clients of the business, as they can expect the quality of service to continue.

In an ideal *MBO*, financial institutions or other fund lending institutions act like venture capitalist and support management of the company in buying out stakes from the promoter(s) of the company. This changes the control of the business. The entire business or a division may be bought out under an *MBO* deal on a going concern basis.
The main ingredients behind the MBO are

- Company's management creates and completes the deal
- Either sale of a division or sale of promoter's stake
- Business is sold on going concern basis
- Control changes from the hands of promoter's to management
- A third party, normally Financial Institution, backs up the management financially to buy out the controlling stake

Rationale of MBO deal from existing promoter:

- The company intend to unlock the value of business by selling it which it considered as non-core
- Promoters are no longer interested in continuing the business or consider it a non-profitable and looking for other parkway for their funds.
- The promoters does not have any succession plan and over the period, the management has understood the business well and can take it ahead with same vision, values and similar pursuit.

Differentiating factor between and Ideal MBO and other restructuring:

A: Motive
Prime motive of all these kind of restructuring could be to unlock the value of the business by separating the non-core business from the core. One way of separating the business could be demerger. But, generally the demerged business is created as separate

legal identity and controlled by the same promoters. Thus, many a time the motive of management to focus on the core business is lost. In MBOs, there is no new legal identity as such is created. On the other hand, in MBOs, management with its clear understanding of the business, runs the company after acquiring the controlling stake.

B: Deal structure and parties involved
In other kind of restructuring, deal structures are generally different from those in MBOs. A simple acquisition of the promoters' stake may not involve debt from financial institutions. A leveraged buyout involves using debt from financial institutions to fund the acquisition but it is different from MBO as in leveraged buyout the buyers are outsiders and in the case of MBO, it is the existing management.

C: Risk
Like leveraged buyouts, MBOs have same financial risk but since the same management is running the business, the risk of losing vision and values is very low, which gives positive signals to the smaller shareholders

What are the probable industries where MBOs are critical/important?
MBOs are important for all those industries where senior employees/management is critical, for example Pharmaceutical, software and other intensive research based industries. As the top executives are very important, these sorts of companies are ideal for MBOs rather than selling stake to any outsiders.

Distressed companies will benefit much from MBOs. Promoters would like to exit the business. If management is confident enough to revive the business then, these companies would be ideal to undergo such deals

How to approach a Management Buyout?
If you're part of the management team that wants to buyout the current owner(s), then you'll have to be thoughtful in your approach (or you may be approached by the owner).
Put together a thoughtful proposal outlining why you want to buy the business, what you think it's worth, and how you would finance the purchase.

Be sure to do your due diligence, including building a financial model and performing a thorough valuation analysis.

It's important to know which members of management will participate in the buyout and which members will not. From there you will have to choose a fair way of distributing equity in the transaction.

How to finance an MBO (or LMBO)?
As mentioned above, you'll need a business plan and a business forecast, financial model, and valuation.
If it's a smaller transaction, then you'll likely be getting your financing from a single institution, but if it's a larger transaction, then you'll likely have to syndicate the deal across a group of institutions.
Consider using a vendor take-back note to help fund the transaction.
This can have milestones attached to it in the case of an earn-out, or can be paid independently of operating results.

Top 10 things to consider when planning a Management Buyout

Here are some of the most important points to consider when planning a MBO:

1. Research the feasibility of the transaction
2. Be open and transparent with executives and shareholders
3. Cut key employees in on the deal (share the equity)
4. Have a strong employee and customer retention plan
5. Develop a thorough understanding of the value of the business (financial modeling and valuation)
6. Get your financing all lined up
7. Don’t get hostile, remain friendly
8. Design a well thought out shareholders agreement
9. Keep the buyout low key until the deal is signed
10. Don’t neglect the operations of the business while working on the deal

MBO Scenario in India

Private equity players in India, triggered by consolidation of domestic businesses, cross-border M&As (merger and acquisitions) and split in family-owned companies, are going for big buyouts, mostly, management buyouts.

The first six months of the year 2007 alone saw 29 PE deals worth $2,435.3 million taking place in the country, compared with 68 deals worth $2328.3 last year (full year), according to Thomson Financial.

Globally, India ranks 16 among the countries with most PE deals signed in 2007. It tops the chart among the BRIC (Brazil, Russia, India and China) countries, followed by Brazil, which had PE buyout deals worth $1,543.6 million. In comparison, China struck deals worth $678.7 million and Russia saw deals worth $68.1 million.

"With more and more family-owned businesses are becoming smaller or are splitting, and entering into other businesses, domestic firms are entering into M&A deals and consolidations taking place, we will see a lot more PE deals in India. Most of our buyouts have been not for leverage but for growth," said Aluri S Rao, director, ICICI Ventures.

Some of the buyouts by ICICI ventures are Tebma Shipyard, Ace Refractories and Ranbaxy Fine Chemicals, which were later converted into management buyout (MBO).

"PEs bring a lot more focus into a company. They also bring corporate governance into companies, which are family-run businesses, by converting them into management-run businesses. Besides, they also incentivise the management with equity," he explained.

"In 2013 we expect private equity investments in India to be in excess of $10 billion," said Atul Mehta, partner of Ernst &Young’s PE practice.

Some of the top management buyouts in India in the past include the UK-based CDC Capital Partners buying into ICI India and Oak Hill Capital Partners buying out exlService.com (I).

"India is moving towards global trends and some of the largest PE deals globally have been MBOs. MBOs will continue in the days to come and it will be seen across sectors. However, we will see more such deals in the captive BPO segment, as lot of the large companies are exiting from their non-core businesses. The ticket size of MBOs will continue to increase," he added.

Therefore, before planning a takeover of a listed company, any acquirer should understand the compliance requirements under the SEBI regulations and also the requirements under the listing Agreement and the Companies Act.

There could also be some compliance requirements under the Foreign Exchange Management Act if an acquirer was a person resident outside India.

While rare, there are examples of successful MBOs in India. V. Vaidyanathan's MBO at a small non-banking financial company (NBFC) in 2012 was funded by private equity firm Warburg Pincus and led to his setting up of Capital First.

- V Vaidyanathan, Founder and Chairman of Capital First, is a quintessential entrepreneur who embarked on an ambitious plan some eight years ago. Quitting his senior-level Board position at India's largest private-sector bank, he acquired a 10 percent stake in a small beaten-down finance company by leveraging his home and other assets. He immediately defined the mission as "financing small entrepreneurs and consumers in India."
- Between 2010 and 2011, Vaidyanathan used contemporary technologies to build a "proof of concept" retail loan book worth $120m, and demonstrated the unique model to PEs. Based upon this, he secured private equity backing from Warburg Pincus of $159m in 2012 to fund the MBO, and Capital First was founded in the process.
- He grew loan assets to $3b in 2017, and the market capitalisation grew from $120m at the time of the MBO in 2012 to $1.2bn in five years.
- Vaidyanathan then sold a 1.5 percent stake in the company to square his leverage. In 2018, Capital First merged with a listed bank, IDFC Bank, in an all-stock deal, and Vaidyanathan became the CEO of the combined bank, thus acquiring a commercial bank licence for Capital First.
- The bank's shareholders showed their approval, with 99.98 percent of votes in favour, an unheard of mandate in banking circles. MBOs are rare but successful leveraged ones make for management textbooks.
- Vaidyanathan's successful soft touchdown of the MBO and creation of a commercial banking platform, leading to his 2018 award win for Most Inspirational Management Buyout India.

Earlier, in 2007, the management team of Intelenet Global Services (Intelenet), backed by a subsidiary of private equity firm Blackstone Group, acquired the business process outsourcing services provider. The US-based private equity firm Blackstone bought 80 per cent in Intelenet, a business process outsourcing firm from Barclays and HDFC for close to $109 million.

"Through our conversations with Barclays and HDFC, we thought that one of the best options for us would be as a management to tie up with a PE firm. From the perspective of employee retention also, it made a lot of sense," said Susir Kumar, CEO, Intelenet.

Last year (2018), Blackstone sold Intelenet to French firm Teleperformance for $1 billion.

Globally, Michael Dell's 2013 buyout, with backing from private equity firm Silver Lake, of all publicly held stock of Dell Inc., the company he had set up in 1984, is considered a lifesaver for the tech giant, which had fallen on bad times.

The heyday of MBOs came in the 1980s when the appearance of high-yield junk bonds fuelled hundreds of such transactions in the US. The most infamous of these was the attempted but eventually abortive buyout of RJR Nabisco by its chief executive officer F. Ross Johnson, without the knowledge of its board.

Since then, MBOs have gained much respectability, and as businesses become more complex and domain expertise a more relevant ownership requirement, they are becoming a worthwhile option for owners looking to exit, as well as shareholders looking for alternate owners.

Why not enough MBOs in India are happening?
Some critical reasons for dearth of MBO deals in Indian scenario are:

1. **Non-separation of ownership and management control**
   Companies, which started one or two decades back or earlier, were run by family members. A kind of inherited business model has been adopted by most of the companies, be they big or small hence there is hardly any division between management and ownership.

2. **Lack of pragmatic approach among the promoters**
   It is general perception of Indian promoters and the employees/ management that they are capable of running their businesses efficiently, which may not be true.

3. **Lack of deep pocket**
   Even if the ownership and management is separated in some companies, the management does not have the financial strength to acquire the stake.

4. **Lack of participation of lending institutions**
   Banks and FIs are not willing or constrained by legal hassles to participate in the MBO deals. The Few instances of non-typical MBOs have been seen in India only due to investment and business models of private equity firms.

5. **Low risk taking phenomenon among the management**
   Indian management, other than promoters are not willing to take risk running the business.

Case of Jet Airways: A management buyout is not a bad option
Recent media reports suggest a section of staffers at Jet Airways is exploring possibilities to see if there is an option for them to take over the stricken airline through a consortium comprising employees and external investors. The proposal is in a nascent phase, and, while the employees are confident of getting external funding, with little support likely from investors and other financial backers, their effort may be in vain.

Yet management buyouts (MBOs), the process they have proposed for the takeover, may well be an idea whose time has come in India. Worldwide, powered by equity and debt funds, such deals have been growing, particularly in the IT industry. In India though, these have been rather few and far between.

The Jet executives who are fronting the move represent various functions at the airline. In a letter to the chairman of its principal lender State Bank of India, they have referred to the buyout at United Airlines, where in 1994, employees finally sealed a long-running effort to take control of the distressed company, accepting deep cuts in salaries and benefits in return for a majority stake. That MBO was driven by the pilots' union, though eventually it involved more than 54,000 of the airline's workforce of 75,000.

The United Airlines story did not have a happy ending, though. In 2002, UAL Corp. filed for bankruptcy protection and the employee stock option plan was terminated, though by then the shares had lost all their value.

So, does an MBO make sense at Jet in the present circumstances?

It would be fair to say that with the exit of its promoter Naresh Goyal, Jet's employees do have the most skin in the game. Confronted with unpaid salaries and an uncertain future, senior executives offer the best chance of getting the grounded airline back up in the skies. That alone should give them an edge over other stakeholders.

In hindsight, it is clear that Jet's promoter Goyal ran the airline like a family firm, with his wife and son involved in the taking of key decisions. We know where that went. Indeed, barring a handful, all that most Indian promoters bring to their businesses is the barest of equity.

As for the lenders, they have proved to be utterly inept in making the right judgement calls at appropriate stages of Jet's growth. Once again, that's a familiar pattern. Banks and other financial institutions seem to have no clue about the goings-on in the companies they have lent to. With borrower after borrower having made a soft call to lend either under political pressure or because of poor understanding of the enterprise in question, lenders have continued to throw good money after bad, halting only when the business itself comes to a standstill. This is as true of the much reviled public sector banks as it is of private banks, as recent disclosures in the case of Yes Bank have shown.

Shareholders, for their part, are too narrowly focused on the company's stock price to really bother about the long-term health of the business they are invested in. Indeed, even as Jet's performance was in free fall, its share price kept making surprising gains. There is a reason why in the UK shareholders are not considered part-owners of the company in the eyes of the law.

Against this backdrop, there is clearly a case for Jet's current management to be given a shot at securing the airline's future.

Executives who are keen to undertake a management buyout usually look to do so when the company's stock price is low. Jet Airways' price, at ₹149 per share, is currently at a historical low. If those behind the idea do follow up on their proposal and manage to find the money for it, this MBO could take the company from being publicly traded to being privately held, which may work well in a revival phase. But crucially, for this rescue project to go anywhere, the MBO team will need to have a strategy that is different from the one deployed by the Goyals, and that too, with a particularly superior financial model.

Summary
Promoters who do not have competent successors will find MBOs one of the effective tools to run their businesses. Companies should consider MBOs as one of the strategic alternatives to create more value. Promoters should not hesitate even selling their controlling stake to the management because they have potential to bring better days for the company and in the process promoters' name will still shine in the company.
Management Buy-In could be tried out by the promoters if they do not find the internal management competent.

Regardless of the alternatives the company chooses, Bankers and financial institutions should be proactive and understanding in this form of restructuring by providing the required financial inputs.

Leveraged Buy-out
A leveraged buyout (LBO) is the purchase of a company using a large amount of debt or borrowed cash to fund the acquisition. In other words, it's when a company used a large amount of borrowed funds to purchase another company instead of using its own money or raising capital from investors.

An LBO occurs when a company purchases another by taking out a loan. Typically, the acquiring company uses the assetsof the acquired company as collateral for the new loan.

Before this process can take place a leveraged buyout model is performed to evaluate the acquired company and determine the floor price that delivers an equity return, which meets the buyer's hurdle rate. Financial analysts use operating and valuation assumptions in Excel and create the model to calculate the purchase price that can generate an expected equity return.

Furthermore, a LBO model includes projections for the target's expected cash flows to ensure that the target will be able to cover the principal and interest payments of the loan. To proceed with a buyout, private equity funds ensure that the assets of the target company can be used as warranty (collateral) for the loan required for the buyout.

Let's look at an example.

Example 1
Stephen is an analyst at a private equity fund. He is asked to construct an LBO model to determine the maximum price that the fund should pay for the target company. Stephen makes several operating and valuation assumptions, and he creates an Excel file.

First, he estimates the total cost of the deal given that the target company has a market cap of $3.4 billion and an outstanding debt of $1.8 billion. Therefore, the total cost of the deal is $3.4 + $1.8 = 5.2 billion.

Then, he defines how the deal will be financed. He estimates that the private equity fund will fund $1.0 million, which is the 19.2% of the total cost, and the remaining $4.2 billion will be funded by two separate debts equal to $1.7 billion at an interest rate of 15% and $2.5 billion at an interest rate of 18%. Both loans will have a duration of 10 years.

Then, he defines the future growth rates of the target company. Revenues are expected to grow by 12% until year 5 and by 7% from year 6 to 10 taking into consideration depreciation and capital spending. Working capital is expected to grow at a steady growth rate of 15%.

The next steps in the model include the calculation of the expected cash flows from the leveraged buyout, the capital structure of the costs of debt and equity and the final conclusions. Stephen concludes that the deal should be accepted at a target price of $125.

Note that the LBO activity increases when interest rates are low because the cost of borrowing is lower. Also, when an industry or a sector underperforms, the equity of the target firm is undervalued.

Example 2
David owns an investment firm. He would like to purchase StoreCo, a retail chain. He intends to reform the company into a more cost-effective operation then sell it.
They agree to a purchase price of $100 million. To conduct a leveraged buyout, David first commits $10 million of his firm's money. He then finds a bank to extend a loan for the remaining $90 million.
David's firm is negotiating this loan, but it will soon own StoreCo. So the loan is structured such that StoreCo will assume this debt. The bank will secure its $90 million with StoreCo's assets. This means that StoreCo will be responsible for making all payments on the debt that David used to buy it, and that if StoreCo defaults on these obligations the bank will seize its land, inventory and other assets in lieu of payment.

Uses of a Leveraged Buyout

A leveraged buyout has four main purposes:

1. To Privatize a Public Company

Taking a publicly traded company private means consolidating its public shares in the hands of private investors who take those shares off the market. Those investors will now own either all or a majority of the target company. This requires enough capital to purchase all or most of the company's net value.

Since these investors will now own the company, they can have the company assume the debt liability for this transaction.

2. To Break Up a Large Company

Sometimes a company may grow large and inefficient, such that the whole is worth less than the sum of its parts. In this case an investor may purchase the company and split it off, selling it as a series of smaller companies.

For example, a company that manufactures cars, airplanes and tanks might get split up into an automotive, an aerospace and a defense firm, each of which would get sold to larger companies in the relevant industries.

In this case the investor would buy the company through a leveraged buyout in the belief that these individual sales will more than pay off that loan.

3. To Improve an Underperforming Company

Finally, an investor might believe that a firm is significantly underperforming its potential. In this case the purchase price of the company would be worth much less than what the company could eventually be worth, making a leveraged buyout a good option.

This is the case with our example above. David believes that ShopCo could be worth substantially more than it currently is. He will have it assume $100 million in debt because he believes that in five years the company will be worth $200 million or more.

Another investor might purchase ShopCo with the intention of holding and operating the company, believing that he can improve the company and generate profits worth considerably more than the debt payments.

There is a fourth, less valuable, use for the leveraged buyout.

4. To Enrich Shareholders and Owners

When a company is purchased, the purchase price flows to all owners and the stock price generally surges. For a privately held firm the individual owner(s) collect that money directly minus any partnerships or other liabilities.

For a publicly held firm the purchase capital accrues to shareholders. This typically enriches executives and members of the board of directors. The former group will often have their compensation tied to stock performance, while the latter group typically comprises some of the company's largest shareholders.

However, this means that a leveraged buyout comes with a significant conflict of interest.
The decision makers in charge of approving any acquisition stand to personally make a lot of money off the resulting deal, even if it means saddling the company with unsustainable debt obligations.

In fact, in cases where an investor is purchasing the firm, often that investor will already own significant holdings in the target firm, giving them a a stake in this personal enrichment.

This is not dissimilar from the practice of leveraged buybacks, in which shareholders will have a company assume significant debt in order to buy back its own stock on the open market. In both cases the company takes on a significant financial liability in a transaction that directly enriches the individuals making that decision.

Advantages of an LBO

The main advantage of a leveraged buyout to the company that is *buying the business* is the return on equity. Using a capital structure that has a substantial amount of debt allows them to increase returns by leveraging the seller’s assets. There can also be some tax benefits, though these are beyond the scope of this article.

From the *seller's perspective*, there are advantages to using an LBO. First and foremost, it is one of the many ways that an owner can sell a business. Most sellers will go through with the LBO process as long as it allows them to exit the business at their desired price.

Leveraged buyouts also allow for the sale of companies that are in distress or going through a turnaround. They provide a viable exit to the seller while also allowing the business to continue operating while the problems are fixed.

Disadvantages of an LBO
From a buyer's perspective, LBOs have some risks. The main disadvantage is that, once the deal is completed, the target business is very leveraged. This scenario allows for *little margin of error*. A problem with liquidity, such as the loss of a few key customers, could put the business in serious distress.

From a seller's perspective as well, executing a leveraged buyout has some disadvantages. Buyers usually undertake an extensive due diligence process. This process can consume time and resources which could be spent managing the business.

Furthermore, their lenders may also want to do their own due diligence, adding to the disruption. Lastly, even after all this effort, the transaction *could fall through if a key lender is not comfortable with its findings*.

Structure
A leveraged buyout can be structured in various ways. However, the two most common structures are:

1. The buyer purchases the assets
In this structure, the buyer purchases only the assets of the target company. The assets are placed in a new corporate entity designed to hold the assets and operate the business. Commonly, the selling company is referred to as "Oldco" ("old company"), and the new company that will hold the assets is referred to as "Newco" ("new company").

The main advantage of this structure is that it allows the buyer to purchase the assets cleanly, limiting potential liabilities from the old company's past activities. Note that this description is an oversimplification of the matter. In certain cases, a lawsuit could invalidate this protection.

2. The buyer purchases the whole company
Another way to purchase the company is to absorb it into the buyer's existing company. This strategy may make sense in some circumstances, though it can open the door to future liability.

How is the purchase financed?
Most small and midsize company leveraged buyouts usually require two types of financing. The buyer needs funds to acquire the company. They also need some financing to operate and expand the business.
The type of debt that is used to acquire the company depends on a number of variables such as the financial health of the buyer and the seller, their reputations, and the size of the transaction. Larger transactions that involve well-known companies commonly use a mix of bonds, senior and mezzanine financing, and conventional bank lending.

On the other hand, smaller transactions, or those involving companies that are not well known, tend to use alternative financing options. These options include:

1. Seller financing:
Many small to midsize leveraged buyout transactions have a seller-financing component. Basically, the seller takes a note from the buyer that is amortized over a period of time. Seller financing is an advantage to the buyer, since sellers tend to be more willing than banks to provide financing. This type of financing is common in smaller transactions and in management buyouts (a form of leveraged buyout).

2. Assumption of debt:
In many cases, as part of the payment, the acquiring company can assume some – or all – of the target company's debt.

3. Bank loans:
Bank financing is also commonly used in small and midsize leveraged buyouts. Usually, the buyer takes a loan and uses it to cover part of the purchase price. Keep in mind that banks seldom provide 100% of the funds needed to purchase the company. They often require that the buyer use its own capital as well.

4. Asset based funding:
This funding is used to secure loans against certain assets, such as real estate and machinery. This option is more common in transactions that include real estate or that have machinery that is in good condition and paid off.

How are operating costs financed?
Once you own the company, you are faced with having to pay for regular operating expenses – *plus the cost of any acquisition financing*. This expense can create a problem if cash flow is tight, or if the company is going through a turnaround. Most companies will need funding to help with cash flow. Common funding alternatives include:

1. Factoring:
Factoring is a type of financing that allows the buyer to leverage the company's accounts receivable. Factoring improves cash flow, which, in turn, leaves the company in a better position to make
financing payments, meet payroll, or pay suppliers. Learn more about factoring.

2. Inventory financing:
Inventory financing is a type of funding that lets you finance your existing, free-and-clear inventory. Your company can usually finance up to 80% of the forced sales liquidation value, or, in some instances, the net orderly liquidation value. Note that the liquidation value of inventory can be substantially lower than the price you paid for it. Learn more about inventory financing**.**

3. Asset based lending:
Asset based lending offers a combined facility that allows you to leverage your accounts receivable, equipment, inventory, and, in some cases, property. It's often used by larger companies as an alternative to factoring and inventory financing. Learn more about asset-based lending.

4. Bank financing:
A great way to finance operations is through a line of credit, assuming that you meet the bank's lending requirements. Lines of credit provide great flexibility at a very reasonable cost. Just remember that lines of credit have a number of covenants, including keeping certain financial ratios at a specific level. This goal may be difficult to achieve in certain leveraged buyout scenarios. Learn more about lines of credit.

Paying the seller vs. paying for operational costs
A major challenge of executing an LBO correctly is making sure the acquired company has enough working capital to operate *after the transaction completes*. Buyers often try to use every available asset from the seller to make the initial payment. This strategy can backfire.
It's best to use assets such as accounts receivable and inventory to finance operations (after the sale), rather than to finance the initial acquisition. Using these assets to finance the acquisition cost could leave you without any resources to cover operating expenses. This approach could create a serious cash flow problem which could derail the whole acquisition.

10 Most Famous Leveraged Buyouts
Debt comes in many different forms from credit cards, to loans, to mortgages. It's a very important part of the business world and is used by both individuals and corporations. People can use debt to buy homes and cars, or to make everyday purchases without having to pay for them right away. Similarly, companies can borrow money from lenders to fund their businesses, conduct much-needed research and development (R&D), or even for their expansion plans. This includes making acquisitions. These are called leveraged buyouts (LBOs). Following are the most famous buyouts in business history across the world.

1. Energy Future Holdings
2. Hilton Hotel
3. Clear Channel
4. Kinder Morgan
5. RJR Nabisco, Inc.
6. Freescale Semiconductor, Inc.
7. PetSmart, Inc.
8. Georgia-Pacific LLC
9. Harrah's Entertainment
10. First Data Corporation

1. Energy Future Holdings

In an era of so-called mega-buyouts between 2005 and 2007, the biggest of them all was the $48 billion acquisition of the largest electricity utility in Texas, then known as TXU, by a consortium led by Kohlberg Kravis Roberts & Co., Texas Pacific Group (TPG Capital), and Goldman Sachs.

The deal was based on the belief that rising demand for energy would stretch supply and push up electricity prices. Shortly after the deal was completed, increased horizontal drilling, or fracking, led to the U.S. shale gas revolution and energy prices tumbled.

The newly-founded company, Energy Future Holdings, filed for Chapter 11 bankruptcy in 2014, qualifying as one of the 10 biggest nonfinancial bankruptcies in history. America's most famous investor, Warren Buffett, was even convinced the deal could not miss and ended up losing nearly $900 million.

2. Hilton Hotel

At the height of the real estate bubble in 2007, the Blackstone Group bought Hilton in a $26 billion leveraged buyout. When the economy slumped into crisis soon after the deal was struck, it appeared it could not have picked a worse time, especially when some of its partners—Bear Stearns and Lehman Brothers—fell apart.

Things turned around drastically when the company went public in 2013, famously transforming the Hilton deal into the most profitable private equity deal ever. The investors who weathered the storm became legendary, making $12 billion on what many analysts believe to be the best-leveraged buyout of all time.

In 2018, Blackstone sold its stake in the hotel chain. The private equity firm unloaded 15.8 million shares. Hilton estimated the sale would generate $1.32 billion.

3. Clear Channel

The nation's largest radio station owner was acquired in 2006 by Bain Capital and Thomas H. Lee Partners for $27 billion. This figure included an $8 million repayment of debt. In a deal that got messy, the private equity firms involved went to court to force the banks to complete the largest buyout in the media and entertainment industry.

In 2014, the company changed its name to iHeartMedia, Inc. in an effort to reflect its evolving strategy as more listeners go online and listen to music via the iHeartRadio app.

4. Kinder Morgan

The Houston-based pipeline operating company Kinder Morgan agreed to a buyout offer from a group of investors led by its chairman and co-founder, Richard Kinder. In a story full of twists and turns, shareholders sued, believing Kinder kept the deal a secret from his own board. The deal was highly criticized for the abundance of conflicts of interests.

Having only advised the company previously, Goldman Sachs became part of the investment group that helped Richard Kinder complete the deal to buy his own company. The company was taken public in 2011 in the largest American private equity-backed initial public offering (IPO) ever.

5. RJR Nabisco, Inc.

Decades later, the RJR Nabisco deal of 1989 is still the most iconic and famous private leveraged buyout of all time. By pulling off the deal valued at $31 billion, or $55 billion when adjusted for inflation, Kohlberg, Kravis, Roberts & Co. is credited with spawning the boom of leveraged buyouts that followed.

The deal was so groundbreaking, it was the inspiration for a book and successful movie, both titled "Barbarians at the Gate." Spoiler alert: RJR Nabisco ended up being broken up and KKR vowed to never put so much into one investment again.

6. Freescale Semiconductor, Inc.

A familiar face to many of the largest leveraged buyouts in history, the Blackstone Group was part of a consortium of investors that were part of the 2006 buyout of Freescale Semiconductor for $18 billion. The acquisition of the former Motorola property is famous for being the largest leveraged buyout of a technology firm in history.

The company almost did not survive after severely underestimating its debts but rose from the ashes with a 2011 IPO.

7. PetSmart, Inc.

In an era when leveraged buyouts are much less common, the $9 billion acquisition of PetSmart in 2014 is notable for being one of the largest leveraged buyouts since 2007.

A group led by the British buyout firm BC Partners was among several interested investment groups looking to improve upon the company’s lagging sales. Many felt PetSmart could easily improve its market share by devoting more resources to its online platforms that had been largely ignored.

8. Georgia-Pacific LLC

Famous for making Dixie cups and Brawny paper towels, Georgia-Pacific was taken over by Koch Industries in 2005 in a deal worth $21 billion. David Koch and his brother Charles are famous for being two of the richest people in America and for their sizable contributions to conservative causes.

Together, they ran the family-controlled conglomerate with a wide range of dealings in everything from energy, commodities, pulp and paper, chemicals, ranching, securities, and finance. This deal is famous for helping Koch industries become the nation’s largest privately held company. David Koch retired from the company in June 2018 because of his failing health. He died in August 2019.

9. Harrah’s Entertainment

They say the house never loses, but the 2006 acquisition of Harrah’s, the world’s largest casino company, is famous for bucking that trend. Not long after the $31 billion leveraged buyout took place, the housing market collapsed and the tourism industry slumped.

After changing its name to Caesars Entertainment, the company withdrew its filing for an IPO in 2010 and lost $831 million that year. In 2015, the legendary gambling empire filed for Chapter 11 bankruptcy.

10. First Data Corporation

In 2007, buyout firm Kohlberg Kravis Roberts & Co. acquired the credit card processing giant First Data for $30 billion. The deal looked to be a disaster soon after it was completed due to the financial crisis, but First Data hung on and is one of KKR's only surviving precrisis acquisitions.

In 2015, First Data began a comeback by selling apps and big data services to small businesses leading up to its official IPO. First Data's story is one of the few success stories from the boom of leveraged buyouts.

LBO and India

Following table shows the list of successful LBO by Indian company. The first being done by Tata Tea in 2000 for UK based Tetley.

Target Company	Country	Indian Company	Value	Type
Tetley	United Kingdom	Tata Tea	GBP 271 million	LBO
Whyte & Mackay	United Kingdom	UB Group	GBP 550 million	LBO
Corus	United Kingdom	Tata Steel	USD 11.3 billion	LBO
Hansen Transmissions	Netherlands	Suzlon Energy	EUR 465 million	LBO
American Axle	USA	Tata Motors	USD 2 billion	LBO
Lombardini	Italy	Zoom Auto Ancillaries	USD 225 million	LBO

LBOs can again be differentiated based on the country of existence. In the case where the target company is located in countries such as the United Kingdom or the United States, the acquiring Indian companies or the financial investors for that matter are able to obtain financing for the leveraged buyouts from foreign banks and the buyout is governed largely by the laws and regulations of the target company's country.

On the other hand, a leveraged buyout of an Indian company by either an Indian or a foreign acquirer needs to comply with the legal framework in India and the scope of execution permissible in India. Owing to the stringent laws and regulations imposed by the GoI, Ministry of Finance, RBI, etc. LBO is not seen as a viable solution for companies.

Some of the laws and restrictions are mentioned as under:

- Reserve Banks restriction on Lending
- Underdeveloped Corporate Debt Market
- Prohibition on Borrowing from Indian Banks – FIPB
- Restrictions on Public Companies from Providing Assistance to Potential Acquirers
- Restrictions Relating to Exit Through Public Listing
- Restriction in FDI and FII investment in India
- Existence of FDI cap across many sectors in India.

These issues prevent the companies to go for Leveraged Buy Out and thus it is not seen as a feasible.

Risk associated with the Execution of LBO

Following are the risk associated with LBOs:

i) Equity holders –

Significant risk arises due to financial leverage. Interest costs for the debt are "fixed costs" which can lead to default of a company if not paid within the stipulated time. Changes in enterprise value (EV) of a company can have immense impact on the equity value. (Provided the debt remains fixed)

ii) Debt holders –

Risk of default always lies with the debt holder which lies with high leverage. Owing to the fact that debt holders retain the most senior claims on the assets of the company, they are likely to suffer less risk compared to others. They are likely to realize a partial, if not full, return on their investments, even in bankruptcy.

Return for an LBO

As we have already seen in an LBO transaction, financial buyers generate high returns on equity investments. Also financial leverage (debt) is used to increase the potential returns. Investment opportunity is evaluated using IRR which measure returns on invested equity. IRR as we know is the discount rate at which the NPV of cash flows equals zero.

IRR is then compared with the hurdle rate (minimum required IRRs) to evaluate the earnings and potential to profit making. Success of an LBO is also sometimes measured using metric called "cash-on-cash" or the CoC which is calculated as the final value of the equity investment at exit divided by the initial equity investment. It is expressed as multiple. An investor getting a COC of 3.0x is said to have "tripled its money".

Following are the three factors which drives the return for an LBO:

- De-levering (paying down debt)
- Operational improvement (e.g. margin expansion, revenue growth)
- Multiple expansion (buying low and selling high).

Things to Consider in an LBO Transaction

Before going for an LBO transaction, it is important to study the following characteristics about an LBO transaction:

I. Industry characteristics

- Type of industry
- Competitive position
- Cyclicality of the industry
- Major players and drivers of the industry
- Potential outside factors (politics, changing laws and regulations, etc.).

II. Company-specific characteristics

- Strategic positioning within the industry in terms of market share
- Growth opportunity
- Operating leverage
- Sustainability of operating margins
- Potential for margin improvement
- Working capital requirements

- Cash requirement to run the business
- Ability of management to operate effectively in a highly levered situation

III. Market conditions

- Accessibility and cost of bank and high yield debt
- Expected equity returns.

Criticisms of the Leveraged Buyout

This leads directly to the main criticism of the leveraged buyout: That it is a predatory tactic.

A leveraged buyout has potentially significant value when used properly. It can allow an investor or business leader with good ideas to reform a company even if he or she doesn't have access to substantial capital.

In our example above, David might be exactly the right person to make ShopCo a thriving 21st century concern. A leveraged buyout allows him to try without risking the utter ruin of his investment firm if the project fails.

However, leveraged buyouts can destroy otherwise healthy businesses. It is not uncommon for companies targeted by a leveraged buyout to eventually file for bankruptcy due to unsustainable debt payments imposed by this tactic. In recent years the average leveraged buyout has imposed debt almost seven times the target company's EBITDA (essentially, the company's earnings before expenses).

This is what happened, for example, when investor Sam Zell purchased the Tribune Company. In 2007 he used a leveraged buyout to take over the media company, which at the time of purchase was profitable. This imposed $13 billion in debt on the company, which severely disrupted its cash flow. The Tribune Company struggled to meet the obligations imposed by Zell's buyout, and by 2008 it had filed for bankruptcy as a direct result of the debt payments.

Financial Instability

The leveraged buyout also has received significant criticism from financial regulators and market watchers.An LBO is a highly leveraged transaction, as noted above. This means, however, that the lending institution is far more exposed than it would be in an ordinary transaction. The threat of default is higher, because the larger debt leads to higher payments.

The consequences of default are also more severe. The bank risks losing far more money in a transaction this highly leveraged, and the underlying firm risks bankruptcy and (potentially) liquidation if it can't make its payments on time.

In this context, regulators have grown increasingly concerned over a boom in leveraged buyout loans in the past several years. As Reuters has reported, "the volume of leveraged loans in particular reached $1.3 trillion in the U.S. and Europe in 2018, versus $734 billion in 2007." This amount of debt means that even a small number of defaults could suck capital out of lending institutions and collapse firms, leading to a cascade reaction of losses.

Module II: SAST Regulations 2011

Introduction to SAST Regulations

Vide Notification dated September 23, 2011, Market watchdog SEBI has notified the much awaited New Takeover Regulations namely SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (hereinafter referred to as "SEBI (SAST) Regulations, 2011") which will replace the existing Takeover (SAST) Regulations, 1997.

The new Regulations shall come into force on the 30th day from the date of their publication in the Official Gazette i.e. w.e.f. October 22, 2011, any acquisition or sale of shares of Listed Company shall be governed by provisions of SEBI (SAST) Regulations, 2011.

Comparison of the New Takeover Code with the Old Takeover Code

1) Increase in Initial Threshold Limit from 15% to 25%:
The Initial Threshold limit provided for Open Offer obligations is increased from 15% to 25% of the voting rights of the Target Company. Since SEBI (SAST) Regulations, 2011 will be applicable from October 22, 2011, thus it's a last opportunity for all the Promoters holding less than 25% but more than 20% to come within bracket of Creeping Acquisition.

Otherwise even the existing Promoters of these Companies have to give offer to consolidate their holding.

2) Creeping Acquisition Limit raised from 15%-55% to 25%-75%:
Now there will a single and clear creeping acquisition bracket. This will be available to all persons holding 25% or more but up to 75% i.e. maximum permissible non-public holding shall be eligible for creeping acquisition of 5% each financial year.

3) Open Offer Trigger Point based on Individual Holding:
Now the Individual Acquirer Shareholding shall also be considered for determining the Open Offer Trigger Points apart from consolidated promoter shareholding. (Regulation 3(3) of SEBI (SAST) Regulations, 2011).

4) Increase in Offer Size from 20% to 26%:
The Offer Size is increased only up to 26% instead of TRAC Recommendation of 100%. It's a good move from the point of view of domestic acquirers on account of lack of proper bank funding options available in India.

5) New Provisions in case of increase in shareholding beyond the maximum permissible non-public shareholding due to Open Offer:

- Obligation on the acquirer to bring down the non-public shareholding to the level specified and within the time permitted under Securities Contract (Regulation) Rules, 1957;
- Ineligibility to make a voluntary delisting offer under SEBI (Delisting of Equity Shares) Regulations, 2009, unless a period of twelve months has elapsed from the date of the completion of the offer period.

6) Abolition of Non-compete fees:
SEBI has accepted the TRAC Recommendation of scrapping the non-compete fee or control premium. Any amount paid to the Promoters/Sellers whether as consideration, non-compete fee or control premium or otherwise, shall be added in Offer Price and hence public shareholders shall be given offer at the highest of such prices.

7) Definition of "Control" modified:
A new definition of Control has been introduced in the new Regulation which is similar to recommendation of TRAC Report with an exception that the word "Ability" has been removed. The definition is as under:

"Control" includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner:

Provided that a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position

8) Change in Control:
Any change in control of the listed company shall be only after Open Offer. The exemption from Open Offer available in case of change in control without acquisition of substantial shares, through a special resolution by postal ballot process, has been withdrawn and now the only route available for change in management and control is through the Open Offer to the shareholders of the Target Company. This is in contrast with the Regulation 12 of the SEBI (SAST) Regulations, 1997 which provides for the change in control through the special resolution passed by way of postal ballot.

9) No Exemption in case of acquisition from other competing acquirer in the New Takeover Code.

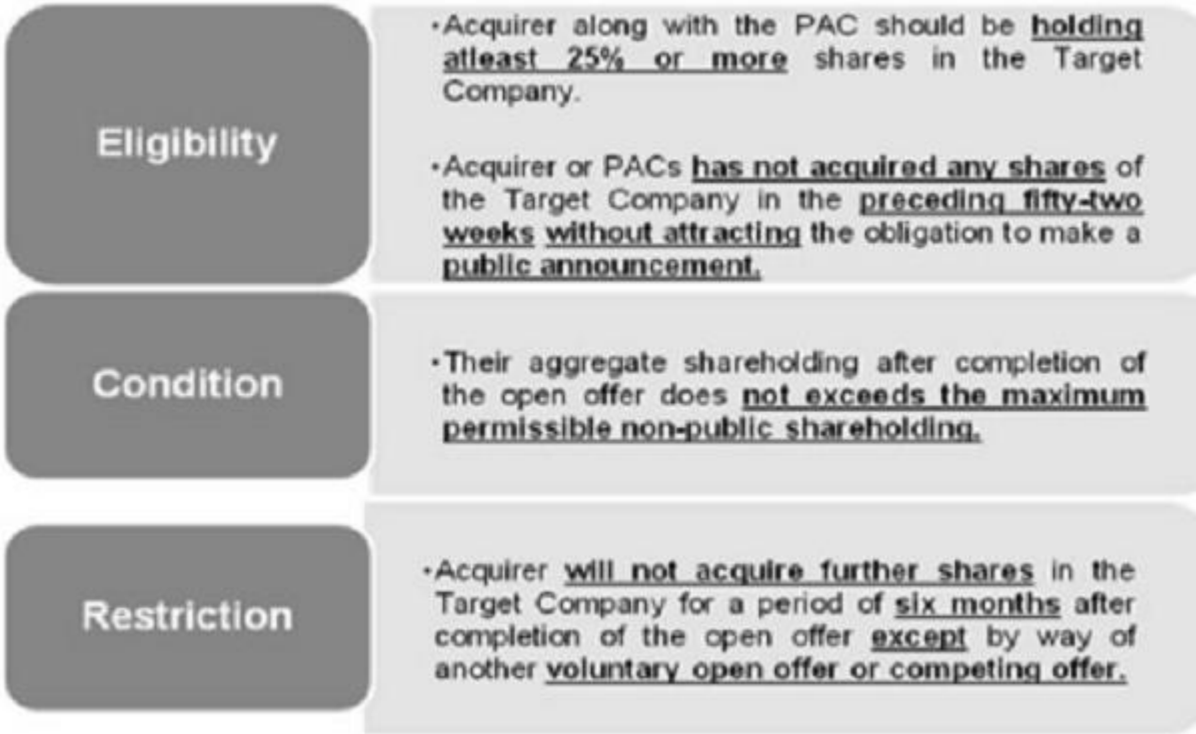
10) Frequently Traded Shares:
For determining the frequency of trading in shares, the trading turnover during the 12 months preceding the month in which the Public Announcement is made will be considered. Further, the volume of trading for frequently traded company increase from 5% to 10% to have a more realistic picture.
11) New Definitions Introduced:

- **"Enterprise Value"** means the value calculated as market capitalization of a company plus debt, minority interest and preferred shares, minus total cash and cash equivalents.
- **"Volume weighted average market price"** means the product of the number of equity shares traded on a stock exchange and the price of each equity share divided by the total number of equity shares traded on the stock exchange.
- **"Volume weighted average price"** means the product of the number of equity shares bought and price of each such equity share divided by the total number of equity shares bought.
- **"Weighted average number of total shares"**means the number of shares at the beginning of a period, adjusted for shares cancelled, bought back or issued during the aforesaid period, multiplied by a time-weighing factor.

12) New Formats Introduced for PA, LOO, and Disclosures, Exemptions, Recommendation on the Open Offer by the Board of Directors and so on.

13) Detailed provisions for Voluntary Open Offer:

The concept of voluntary open offer has been separately dealt in the SEBI (SAST) Regulations, 2011.



In case of voluntary open offer, the offer size may be of 10% or more of the voting rights at the will of the Acquirer.

14) Detailed provisions relating to Indirect Acquisition:
The New Regulations prescribes detailed provisions relating to Indirect Acquisitions which is a welcome move as there was quite confusion. The New Regulations define the situations which will be deemed as Indirect Acquisition.

15) Recommendation on the Open Offer by the Board of Target Company:
A recommendation on the offer by the Board of Target Company has been made mandatory and such recommendations shall be published at least two working days before the commencement of the tendering period in the same newspapers where the public announcement of the open offer was published, and simultaneously, a copy of the same shall be sent to SEBI, Stock Exchange and Manager to the Offer.

16) Revision in SEBI fees to be given while submitting the draft letter of offer.

17) Provisions relating to Exemption from Open Offer have been modified.

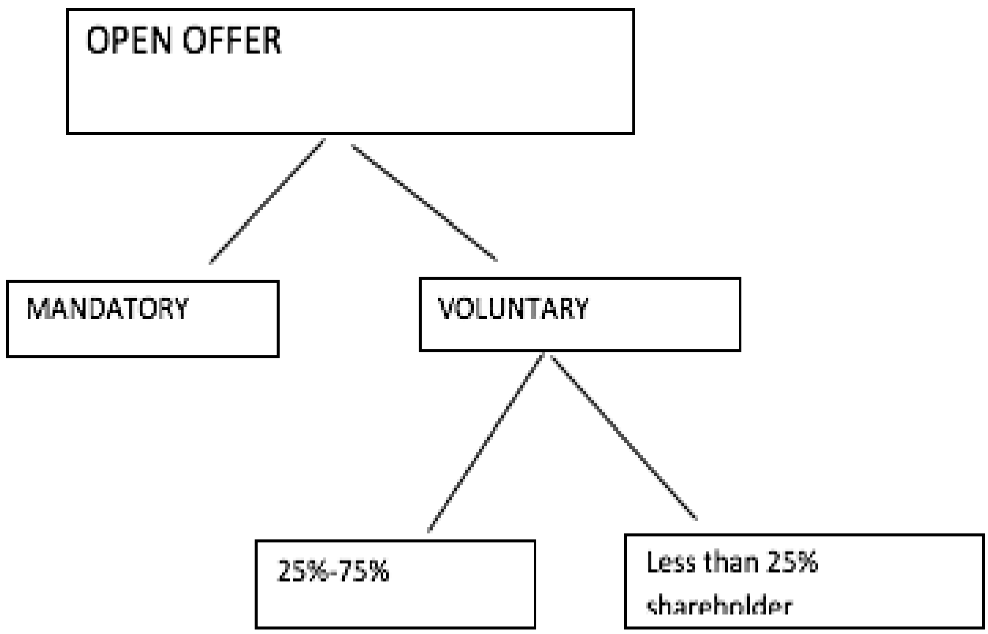
18) Other Consequential Amendments:
Simultaneously with the amendment in SEBI (SAST) Regulations, 2011, the format of disclosure of shareholding as provided under Clause 35 of the Listing Agreement in respect of following has been replaced

- Statement showing holding of securities (including shares, warrants, convertible securities) of persons belonging to the category “Promoter and Promoter Group”, :
- Statement showing holding of securities (including shares, warrants, convertible securities) of persons belonging to the category “Public” and holding more than 1% of the total number of shares;
- Statement showing holding of securities (including shares, warrants, convertible securities) of persons (together with PAC) belonging to the category “Public” and holding more than 5% of the total number of shares of the company.

Trigger Levels

Open Offer Triggers

Across the globe, the jurisprudence of Takeover Regulations revolves around offering an exit opportunity to the public / minority shareholders of a company in the event of any substantial change in shareholding or change in control of the company. It is only fair and equitable that the public stakeholders who have invested in the company, relying on the management or the promoters of the company are given an opportunity to withdraw their investments when there is a change in the management or promoter shareholding.



I) Regulation 3 of SEBI (SAST) Regulations, 2011

It contains provisions regarding the substantial acquisition of shares or voting rights of the Target Company. It provides specific limits beyond which the acquirer(s) is required to come out with an open offer in accordance with the Regulations.

Major thresholds limit as per SEBI (SAST) Regulations, 2011-

- 0%- 25%
- 25%-75%
- 75% and above

Initial Threshold Limit:
Regulation 3(1) provides that when an acquirer together with PACs intends to acquire shares or voting rights which along with the existing shareholding would entitle him to exercise 25% or more of the voting rights in the target company, in such a case the acquirer is required to make public announcement to acquire at least additional 26% of the voting rights of Target Company from the shareholders through an open offer.

(The **1st trigger point** is during the acquisition of 25% or more shares of the target company by the acquirer company.)

Creeping Acquisition Limit:
Regulation 3(2) allows the persons either by themselves or through PAC with them who are holding more than 25% but less than 75% shares or voting rights in the Target Company to acquire further up to 5% shares or voting rights in the financial year ending 31st March. The allowable acquisition of 5% is popularly known as 'Creeping Acquisition.'

(The **2nd trigger point** is if the acquirer tries to acquire more than 5% of shares in a financial year after the satisfaction of 1st trigger point.)

II) Offer Size

Mandatory Open Offer:
In the mandatory open offer, the acquirer has to give an open offer to the shareholders for acquisition of at least 26% of the total shares of the Target Company.

Voluntary Open Offer:
It means Open Offer given by the acquirer voluntarily without triggering the mandatory Open Offer obligations.

Regulation 6 of SEBI (SAST) Regulations, 2011 deals with Voluntary Open Offer and provides the eligibility, conditions, and restrictions.

Eligibility for making Voluntary Open Offer:
- Acquirer along with PACs should be holding at least 25% or more shares in the Target Company prior to making Voluntary Open Offer.
- The Acquirer or PACs have not acquired any shares of the Target Company in the preceding 52 weeks without attracting the Open Offer obligation.

Conditions for making Voluntary Open Offer:
- The aggregate shareholding after completion of the Voluntary Open Offer should not exceed beyond the maximum permissible non-public shareholding.
- No acquisition during the offer period except under the Voluntary Open Offer.

Restrictions:
The acquirer becomes ineligible to acquire further shares for a period of six months after the completion of Open Offer except by way of:

- Another Voluntary Open Offer;
- Acquisitions by making a competing offer.

Public Offer and Offer Price Determination
Acquisition by way of control whether directly or indirectly would require the acquirer to make public announcement for open offer. Erstwhile regulation 1997, provided that change in control can be through passing of special resolution through postal ballot is now been withdrawn.

Indirect acquisition of shares or control.

Any acquisition of shares or voting rights in or control over Target Company which if acquired directly would trigger a public open offer is considered to be indirect acquisition.

Open Offer size increased from 20% to 26% . The open offer size has been increased from 20% to 26% of the total shares of the target Company.

Offer Price:
Offer price is the price at which the acquirer announces to acquire shares from the public shareholders under the open offer. The offer price shall not be less than the price as calculated under regulation 8 of the SAST Regulations, 2011 for frequently or infrequently traded shares.

Different methods have been provided for determining the offer price of direct acquisition and indirect acquisition. The price is determined at volume weighted average market price at 60 days rather than simple average.

Non-compete fees or control premium or otherwise payable to the exiting sellers shall be included to the price payable to the shareholders of the target company. This would mean that the promoter and the public shareholder would exit at the same price.

If the target company’s shares are frequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement (“SPA”) triggering the offer;

- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement (“PA”);

- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;

- Volume weighted average market price for sixty trading days preceding the PA.

If the target company’s shares are infrequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement (“SPA”) triggering the offer;

- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement ("PA");
- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- The price determined by the acquirer and the manager to the open offer after taking into account valuation parameters including book value, comparable trading multiples, and such other parameters that are customary for valuation of shares of such companies.

It may be noted that the Board may at the expense of the acquirer, require valuation of shares by an independent merchant banker other than the manager to the offer or any independent chartered accountant in practice having a minimum experience of 10 years.

The shares of the target company will be deemed to be frequently traded if the traded turnover on any stock exchange during the 12 calendar months preceding the calendar month, in which the PA is made, is at least 10% of the total number of shares of the target company. If the said turnover is less than 10%, it will be deemed to be infrequently traded.

Minimum size:
It has to be ensured that minimum of 26% of voting capital of the company is being offered subject to minimum public holding requirements.

Date of opening of offer:
The date of opening of offer has to be not later than the 12 working days from the date of receipt of recommendation from SEBI.

Period of offer:
The offer to acquire should remain open for a period of minimum 10 days.

Competitive Bid and Revision:
Ensure to revise the offer price in consultation with merchant bankers in case of competitive bid if any

Consideration-cash:

Payment of consideration (Regulation 21)
For the amount of consideration payable in cash, the acquirer shall open a special escrow account with a banker to an issue registered with the Board and deposit therein, such sum as would, together with cash transferred under clause (b) of sub-regulation (10) of regulation 17, make up the entire sum due and payable to the shareholders as consideration payable under the open offer, and empower the manager to the offer to operate the special escrow account on behalf of the acquirer for the purposes under these regulations.

(2) Subject to provisos to sub-regulation (11) of regulation 18, the acquirer shall complete payment of consideration whether in the form of cash, or as the case may be, by issue, exchange or transfer of securities, to all shareholders who have

tendered shares in acceptance of the open offer, within ten working days of the expiry of the tendering period.

(3) Unclaimed balances, if any, lying to the credit of the special escrow account referred to in sub-regulation (1) at the end of seven years from the date of deposit thereof, shall be transferred to the Investor Protection and Education Fund established under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009.

Directors of the target company (Regulation 24)

(1) During the offer period, no person representing the acquirer or any person acting in concert with him shall be appointed as director on the board of directors of the target company, whether as an additional director or in a casual vacancy:

Provided that after an initial period of fifteen working days from the date of detailed public statement, appointment of persons representing the acquirer or persons acting in concert with him on the board of directors may be effected in the event the acquirer deposits in cash in the escrow account referred to in regulation 17, one hundred per cent of the consideration payable under the open offer:

Provided further that where the acquirer has specified conditions to which the open offer is subject in terms of clause (c) of sub-regulation (1) of regulation 23, no director representing the acquirer may be appointed to the board of directors of the target company during the offer period unless the acquirer has waived or attained such conditions and complies with the requirement of depositing cash in the escrow account.

(2) Where an open offer is made conditional upon minimum level of acceptances, the acquirer and persons acting in concert shall, notwithstanding anything contained in these regulations, and regardless of the size of the cash deposited in the escrow account referred to regulation 17, not be entitled to appoint any director representing the acquirer or any person acting in concert with him on the board of directors of the target company during the offer period.

(3) During the pendency of competing offers, notwithstanding anything contained in these regulations, and regardless of the size of the cash deposited in the escrow account referred to in regulation 17, by any acquirer or person acting in concert with him, there shall be no induction of any new director to the board of directors of the target company:

Provided that in the event of death or incapacitation of any director, the vacancy arising therefrom may be filled by any person subject to approval of such appointment by shareholders of the target company by way of a postal ballot.

(4) In the event the acquirer or any person acting in concert is already represented by a director on the board of the target company, such director shall be participate in any deliberations of the board of directors of the target company or vote on any matter in relation to the open offer.

Obligation of target company

Once a PA is made, the board of directors of the Target Company is expected to ensure that the business of the target company is conducted in the ordinary course. Alienation of material assets, material borrowings, issue of any authorized securities, announcement of a buyback offer etc. is not permitted, unless authorized by shareholders by way of a special resolution by postal ballot.

- The target company shall furnish to the acquirer within two working days from the identified date, a list of shareholders and a list of persons whose applications, if any, for registration of transfer of shares, in case of physical shares, are pending with the target company.

- After closure of the open offer, the target company is required to provide assistance to the acquirer in verification of the shares tendered for acceptance under the open offer, in case of physical shares.

- Upon receipt of the detailed public statement, the board of directors of the target company shall constitute a committee of independent directors to provide reasoned recommendations on such open offer, and the target company shall publish such recommendations and such committee shall be entitled to seek external professional advice at the expense of the target company.

  The recommendations of the Independent Directors are published in the same newspaper where the Detailed Public Statement is published by the acquirer and are published at least 2 working days before opening of the offer. The recommendation will also be sent to SEBI, Stock Exchanges and the Manager to the offer.

Obligations of the acquirer

(1) Prior to making the public announcement of an open offer for acquiring shares under these regulations, the acquirer shall ensure that firm financial arrangements have been made for fulfilling the payment obligations under the open offer and that the acquirer is able to implement the open offer, subject to any statutory approvals for the open offer that may be necessary.

(2) In the event the acquirer has not declared an intention in the detailed public statement and the letter of offer to alienate any material assets of the target company or of any of its subsidiaries whether by way of sale, lease, encumbrance or otherwise outside the ordinary course of business, the acquirer, where he has acquired control over the target company, shall be debarred from causing such alienation for a period of two years after the offer period:

Provided that in the event the target company or any of its subsidiaries is required to so alienate assets despite the intention to alienate not having been expressed by the acquirer, such alienation shall require a special resolution passed by shareholders of the target company, by way of a postal ballot and the notice for such postal ballot shall *inter alia* contain reasons as to why such alienation is necessary.

(3) The acquirer shall ensure that the contents of the public announcement, the detailed public statement, the letter of offer and the post-offer advertisement are true, fair and adequate in all material aspects and not misleading in any material particular, and are based on reliable sources, and state the source wherever necessary.

(4) The acquirer and persons acting in concert with him shall not sell shares of the target company held by them, during the offer period.

(5) The acquirer and persons acting in concert with him shall be jointly and severally responsible for fulfillment of applicable obligations under these regulations

Obligations of the manager to the open offer.

27.(1) Prior to public announcement being made, the manager to the open offer shall ensure that,—

(a) the acquirer is able to implement the open offer; and

(b) firm arrangements for funds through verifiable means have been made by the acquirer to meet the payment obligations under the open offer.

(2) The manager to the open offer shall ensure that the contents of the public announcement, the detailed public statement and the letter of offer and the post offer advertisement are true, fair and adequate in all material aspects, not misleading in any material particular, are based on reliable sources, state the source wherever necessary, and are in compliance with the requirements under these regulations.

(3) The manager to the open offer shall furnish to the Board a due diligence certificate along with the draft letter of offer filed under Regulation 16.

(4) The manager to the open offer shall ensure that market intermediaries engaged for the purposes of the open offer are registered with the Board.

(5) The manager to the open offer shall exercise diligence, care and professional judgment to ensure compliance with these regulations.

(6) The manager to the open offer shall not deal on his own account in the shares of the target company during the offer period.

(7) The manager to the open offer shall file a report with the Board within fifteen working days from the expiry of the tendering period, in such form as may be specified, confirming status of completion of various open offer requirements.

Consequences of Violation of obligations SEBI (SAST) Regulations, 2011

SAST Regulations, 2011 have laid down the general obligations of acquirer, Target Company and the manager to the open offer. For failure to carry out these obligations as well as for failure / non-compliance of other provisions of these Regulations, penalties have been laid down there under. These penalties include:

- directing the divestment of shares acquired;

- directing the transfer of the shares / proceeds of a directed sale of shares to the investor protection fund;

- directing the target company / any depository not to give effect to any transfer of shares;

- directing the acquirer not to exercise any voting or other rights attached to shares acquired;

- debarring person(s) from accessing the capital market or dealing in securities;

- directing the acquirer to make an open offer at an offer price determined by SEBI in accordance with the Regulations;
- directing the acquirer not to cause, and the target company not to effect, any disposal of assets of the target company or any of its subsidiaries unless mentioned in the letter of offer;

- directing the acquirer to make an offer and pay interest on the offer price for having failed to make an offer or has delayed an open offer;

- directing the acquirer not to make an open offer or enter into a transaction that would trigger an open offer, if the acquirer has failed to make payment of the open offer consideration;

- directing the acquirer to pay interest of for delayed payment of the open offer consideration;

- directing any person to cease and desist from exercising control acquired over any target company;

- directing divestiture of such number of shares as would result in the shareholding of an acquirer and persons acting in concert with him being limited to the maximum permissible non-public shareholding limit or below.

Voluntary open offer:
Voluntary open offer means open offer given by the acquirer voluntarily without triggering the mandatory open offer obligations.
An acquirer can make an open offer of 10% of total shares of target company provided -he directly or with PAC already holds 25% of the shares and

-Has not acquired any shares in the preceding 52 weeks except through open offer. --- He is also restricted to make any acquisition for a period of 6 months after the completion of open offer except through another voluntary open offer or competing offer.

-Post acquisition should not result in maximum permissible non public shareholding.

Independent Director:
The Target Company has an obligation to constitute a committee of independent directors to provide reasoned recommendations to the shareholders about the open offer. This will improve the shareholders confidence and would lead to good corporate governance.

Increase in shareholding beyond the maximum permissible non-public shareholding due to open offer:

When after the completion of the open offer, the shareholding of the acquirer along with the PAC is more than the permissible limit of non-public shareholding (i.e 75% or 90% in some Companies) then;

- It is obligatory on the acquirer to bring down the non-public shareholding to the specified limit (i.e 75% or 90% in PSU's) as permitted by Securities Contract (Regulation) Rules 1957 within one year.
- Further the acquirer is also not eligible to delist the shares from the stock exchanges for a period of twelve months from the completion of the offer period.

Exemptions from making Open offer: -
General Exemptions are granted to the following categories of acquisition subject to fulfillment of specified conditions.

Interest transfer amongst qualifying persons viz., immediate relatives, promoters as mentioned in shareholding pattern of the Company not less than 3 years prior to the proposed acquisition, a company, its subsidiary or holding company or other subsidiaries of the holding company or persons holding not less than 50% of the shares of the Company etc.

Acquisition in the ordinary course of business by stock brokers on behalf of their clients, underwriters.

Acquisitions at subsequent stages, by an acquirer who has made a public announcement of an open offer for acquiring shares pursuant to an agreement of disinvestment.

Acquisition pursuant to Scheme under Sick Industrial Companies (Special Provisions) Act, 1985 or arrangement involving target company as transferor or transferee company in amalgamation, merger or demerger pursuant to an order of Court or Competent authority

Acquisition under operation of law: Pursuant to the provisions of Securitisation and Reconstruction of Financial Assets and Enforcement of security Interest, to the scheme of SEBI (Delisting of shares), transmission or succession or inheritance.

Acquisition of voting rights or preference shares carrying voting rights on account of non payment of dividend

The acquisition of shares of a target company, not involving a change of control over such target company, pursuant to a scheme of corporate debt restructuring in terms of the Corporate Debt Restructuring Scheme.

Increase in voting rights in a target company of any shareholder pursuant to buy-back of shares.

(a).Acquisition of shares by any shareholder of a target company, upto his Entitlement, pursuant to a rights issue;

(b) acquisition of shares by any shareholder of a target company, beyond his entitlement, pursuant to a rights issue, subject to fulfillment of the following conditions:

Acquisition of shares in a target company by any person in exchange for shares of another target company tendered pursuant to an open offer for acquiring shares under these regulations;
Acquisition of shares in a target company from state-level financial institutions or their subsidiaries or companies promoted by them, by promoters of the target company pursuant to an agreement between such transferors and such promoter;
Acquisition of shares in a target company from a venture capital fund or a foreign venture capital investor registered with the Board, by promoters of the target company pursuant to an agreement between such venture capital fund or foreign venture capital investor and such promoters

Exemption by the Board (Regulation 11):
SEBI for reasons recorded in writing may grant exemption from the obligation to make an open offer and from compliance of procedural requirements of the regulation if it deems fit in the interest of the investors and securities market

Disclosures:
The New regulations, 2011 has made it obligatory for the acquirer to make the disclosures whereas it was on the Target Company in erstwhile regulations, 1997.

i. Event Based disclosures:
a. When the acquirer acquires the shares or voting rights in the Target Company, which taken together with the existing holding of him and PAC’s to 5% or more of shares or voting rights of the Target Company, then disclosure in the prescribed format has to be submitted by the acquirer to the stock exchanges and the target company within 2 days of the receipt of intimation of allotment or acquisition.

b. When the acquirer together with the PAC holds more than 5% of the shares or voting rights of the Company, then every acquisition and disposal of shares representing 2% of the shares of the target company has to be informed by the acquirer to the stock exchanges and the target company within 2 days of the acquisition or disposal.

c. Encumbrance of shares: When the shares are encumbered by the promoter or by the persons acting in concert with him, shall disclose the details of creation, invocation and release of the encumbrance to the stock exchange and the Target Company within 7 days of such creation, invocation or release.

ii. Continual Disclosure:
Every person who along with the PAC holds shares or voting rights more than 25% of the shares or voting rights of the target company has to inform the aggregate shareholding or

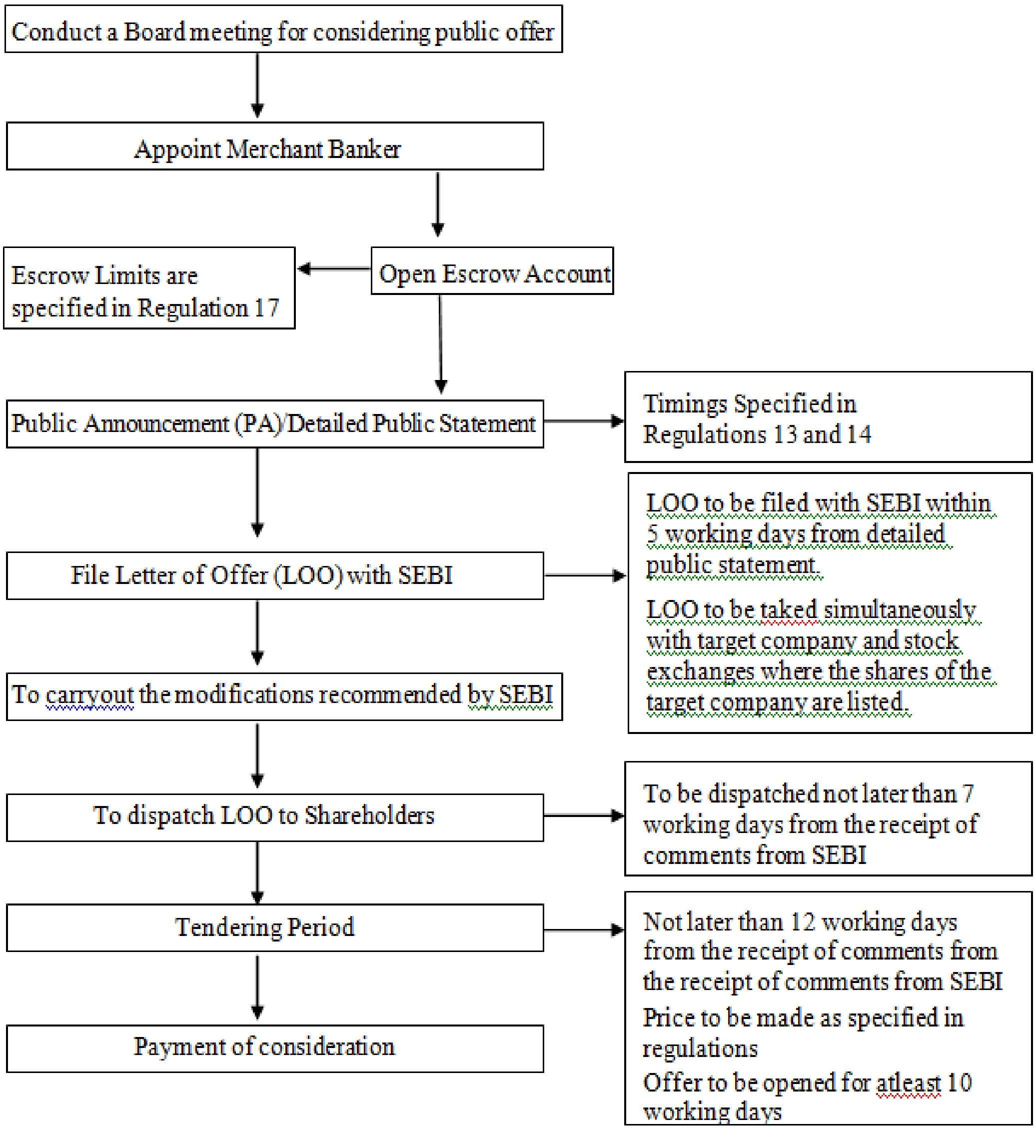
voting rights as of 31st March of every year to the stock exchange and the target company within 7 days from the end of financial year.

The new regulations provides for detailed procedure for open offer covering important points like manager to the open offer, timing, publication of letter of offer, filing with the Board, provision of escrow, payment of consideration, completion of acquisition, withdrawal of offer etc.

To sum up it could be seen that SEBI has made efforts to maintain the balance between the concerns of investors, promoters and shareholders. The benefits being increase in threshold for open offer to the investors, more opportunity for fund raising to the promoters, inclusive of non compete price to be factored in the offer price being beneficial to the shareholders. However it also has negative sides like increase of non compete price to be factored in offer price will increase the cost of acquisition, holding of shares in few hands may affect liquidity in the market.

Procedural Aspects of Acquisitions

The following chart gives an overview of takeover process in India, when there is no competitive bid.



CHECKLISTS ON TAKEOVERS

A. Checklist for Acquirer

Preliminary Examination of a target company:
The acquirer has to undertake a preliminary study on the target company, before taking any action for taking over a company. He may consider the following points.

It may be noted that this list is not an exhaustive checklist and it varies depends on size of the company nature of industry

(a) Information has to be collected on Target Company and to be analysed on financial and legal angle.

(b) Register of members to be examined to verify the profile of the shareholders.

(c) Title of the target company with respect to immovable properties may be verified.

(d) Financial statements of Target Company have to be examined.

(e) Examination of Articles and Memorandum of Association of the Company.

(f) Examination of charges created by the Company

(g) Applicability of FEMA provisions if any relating to FDI has to be looked into.

(h) Import and Export of technology if any

(i) Business prospects etc.

List/details of documents to be obtained from target company is enclosed as ***Annexure A***.

A merchant Banker of Category I have to be appointed. It has to be ensured that the merchant banker is not an associate of or group of acquirer or the target company

Escrow Account:

(i) An escrow account has to be opened and the following sum has to be deposited.

(ii) The escrow amount shall be calculated in the following manner, as specified in regulation 17,—

For consideration payable under the public offer,—

On the first 500 crores	25 per cent; of the consideration
On the balance consideration	an additional amount equal to 10% of balance consideration.

If, an open offer is made conditional upon minimum level of acceptance, hundred percent of the consideration payable in respect of minimum level of acceptance or fifty per cent of the consideration payable under the open offer, whichever is higher, shall be deposited in cash in the escrow account.

(2) The consideration payable under the open offer shall be computed as provided for in sub-regulation (2) of regulation 16 and in the event of an upward revision of the offer price or of the offer size, the value of the escrow amount shall be computed on the revised consideration calculated at such revised offer price, and the additional amount shall be brought into the escrow account prior to effecting such revision.

(3) The escrow account referred to in sub-regulation (1) may be in the form of,—

(a) cash deposited with any scheduled commercial bank;

(b) bank guarantee issued in favour of the manager to the open offer by any scheduled commercial bank; or

(c) deposit of frequently traded and freely transferable equity shares or other freely transferable securities with appropriate margin:

Provided that securities sought to be provided towards escrow account under clause (c) shall be required to conform to the requirements set out in sub-regulation (2) of regulation 9.

Regulation 9(2) specifies the following requirements.

(a) such class of shares are listed on a stock exchange and frequently traded at the time of the public announcement;

(b) such class of shares have been listed for a period of at least two years preceding the date of the public announcement;

(c) the issuer of such class of shares has redressed at least ninety five per cent. of the complaints received from investors by the end of the calendar quarter immediately preceding the calendar month in which the public announcement is made;

(d) the issuer of such class of shares has been in material compliance with the listing agreement for a period of at least two years immediately preceding the date of the public announcement:

Provided that in case where the Board is of the view that a company has not been materially compliant with the provisions of the listing agreement, the offer price shall be paid in cash only;

(e) the impact of auditors' qualifications, if any, on the audited accounts of the issuer of such shares for three immediately preceding financial years does not exceed five per cent. of the net profit or loss after tax of such issuer for the respective years; and

(f) the Board has not issued any direction against the issuer of such shares not to access the capital market or to issue fresh shares.

(4) In the event of the escrow account being created by way of a bank guarantee or by deposit of securities, the acquirer shall also ensure that at least one per cent of the total consideration payable is deposited in cash with a scheduled commercial bank as a part of the escrow account.

(5) For such part of the escrow account as is in the form of a cash deposit with a scheduled commercial bank, the acquirer shall while opening the account, empower the manager to the open offer to instruct the bank to issue a banker's cheque or demand draft or to make payment of the amounts lying to the credit of the escrow account, in accordance with requirements under these regulations.

(6) For such part of the escrow account as is in the form of a bank guarantee, such bank guarantee shall be in favour of the manager to the open offer and shall be kept valid throughout the offer period and for an additional period of thirty days after completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer.

(7) For such part of the escrow account as is in the form of securities, the acquirer shall empower the manager to the open offer to realise the value of such escrow account by sale or otherwise, and in the event there is any shortfall in the amount required to be maintained in the escrow account, the manager to the open offer shall be liable to make good such shortfall.

(8) The manager to the open offer shall not release the escrow account until the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, save and except for transfer of funds to the special escrow account as required under regulation 21.

(9) In the event of non-fulfillment of obligations under these regulations by the acquirer the Board may direct the manager to the open offer to forfeit the escrow account or any amounts lying in the special escrow account, either in full or in part.

(10) The escrow account deposited with the bank in cash shall be released only in the following manner,—

(a) the entire amount to the acquirer upon withdrawal of offer in terms of regulation 23 as certified by the manager to the open offer:

Provided that in the event the withdrawal is pursuant to clause (c) of sub-regulation (1) of regulation 23, the manager to the open offer shall release the escrow account upon receipt of confirmation of such release from the Board;

(b) for transfer of an amount not exceeding ninety per cent of the escrow account, to the special escrow account in accordance with regulation 21;

(c) to the acquirer, the balance of the escrow account after transfer of cash to the special escrow account, on the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, as certified by the manager to the open offer;

(d) the entire amount to the acquirer upon the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, upon certification by the manager to the open offer, where the open offer is for exchange of shares or other secured instruments;

(e) the entire amount to the manager to the open offer, in the event of forfeiture for non-fulfillment of any of the obligations under these regulations, for distribution in the following manner, after deduction of expenses, if any, of registered market intermediaries associated with the open offer,—

- one third of the escrow account to the target company;
- one third of the escrow account to the Investor Protection and Education Fund established under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009; and
- one third of the escrow account to be distributed pro-rata among the shareholders who have accepted the open offer.

Undertakings/Authorisation:

Ensure to obtain following undertakings/authorization.

1. A letter duly authorizing Target Company to realize the value of escrow account in terms of Takeover Regulations.

2. An undertaking to Target Company that none of the Acquirer/Persons Acting in Concert have been prohibited by SEBI from dealing in securities, in terms of direction issued under Section 11B of SEBI Act.

3. An undertaking from the sellers, promoters, directors of the Target Company that they have not been prohibited by SEBI from dealing in securities, in terms if direction issued under Section 11B of SEBI Act.

4. An undertaking from the Target Company that it has complied with the provisions of Listing Agreement, and that any non-compliance or delayed compliance has been brought to the notice of Target Company.

5. An undertaking from the Target Company that it has complied with the provisions of SEBI (SAST) Regulations, and that any non-compliance or delayed compliance has been brought to the notice of Target Company.

Public announcement (PA):

1. Public announcement.

SEBI (SAST) Regulation, 2011 provides that whenever Acquirer acquires the shares or voting rights of the Target Company in excess of the limits prescribed under Regulation 3 and 4, than Acquirer is required to give a Public Announcement of an Open Offer to the shareholder of the Target Company. During the process of making the Public Announcement of an Open Offer, the Acquirer is required to give Public Announcement and publish Detailed Public Statement.

The regulations have prescribed the separate timeline for Public Announcement as well as for Detailed Public Statement.

(i) Public Announcement
(ii) Detailed Public Statement

Timing of Pubic Announcement

The Public Announcement shall be sent to all the stock exchanges on which the shares of the target company are listed. Further, a copy of the same shall also be sent to the Board and to the target company at its registered office within one working day of the date of the public announcement.

The time within which the Public Announcement is required to be made to the Stock Exchanges under different circumstances is tabulated below:

Applicable Regulation	**Particulars**	**Time of making Public Announcement to Stock Exchange**
13(1)	Agreement to Acquirer Shares or Voting Rights or Control Over The Target Company	On the same day of entering into agreement to acquire share, voting rights or control over the Target Company.
13(2)(a)	Market Purchase of shares	Prior to the placement of purchase order with the stock broker.
13(2)(b)	Acquisition pursuant to conversion of Convertible Securities without a fixed date of conversion or upon conversion of depository receipts for the underlying shares	On the same day when the option to convert such securities into shares is exercised.
13(2)(c)	Acquiring shares or voting rights or control pursuant to conversion of Convertible Securities with a fixed date of conversion	On the second working day preceding the scheduled date of conversion of such securities into shares.

13(2)(d)	In case of disinvestment	On the date of execution of agreement for acquisition of shares or voting rights or control over the Target Company.
13(2)(e)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are not met	Within four working days of the following dates, whichever is earlier: a. When the primary acquisition is contracted; And b. Date on which the intention or decision to make the primary acquisition is announced in the public domain.
13(2)(f)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are met	On the same day of the following dates, whichever is earlier: a. When the primary acquisition is contracted; And b. Date on which the intention or decision to make the primary acquisition is announced in the public domain.
13(2)(g)	Acquisition of shares, voting rights or control over the Target Company pursuant to Preferential Issue	On the date when the Special Resolution is passed for allotment of shares under Section 81(1A) of Companies Act 1956.
13(2)(h)	Increase in voting rights pursuant to a buy-back not qualifying for exemption under Regulation 10	Not later than 90th day from the date of increase in voting rights.
13(2)(i)	Acquisition of shares, voting rights or control over the Target Company where the such acquisition is beyond the control of acquirer	Not later than two working days from the date of receipt of such intimation.
13(3)	Voluntary Offer	On the same day when the Acquirer decides to make Voluntary Offer

Timing of Detailed Public Statement

In terms of Regulation 13(4) of SEBI (SAST) Regulations, 2011, a Detailed Public Statement shall be published by the acquirer through the Manager to the Open Offer within maximum **5 working days from the date of Public Announcement.**

However in case of Indirect Acquisition where none of condition specified in Regulation 5(2) are satisfied, the Detailed Public Statement shall be published not later than five working days of the completion of the primary acquisition of shares or voting rights in or control over the company or entity holding shares or voting rights in, or control over the target company.

Publication of Public Announcement and Detailed Public Statement

Regulation 14 of SEBI (SAST) Regulation, 2011 provides the requirements relating to publication of Public Announcement and Detailed Public Statement which are tabulated below:

Regulation	**Particulars**	**Time**	**To whom**
14(1)	Public Announcement	On the same day	All the stock exchanges on which the shares of the target company are listed. The stock exchanges shall forthwith disseminate such information to the public.
14(2)	Public Announcement	One working day of the date of the public announcement	Board and to the target company at its registered office
14(3)	Detailed Public Statement	5 working days from the date of Public Announcement.	Publication in the following newspaper: (a) One Hindi national language daily with wide circulation (b) One English national language daily with wide circulation (c) One regional national language daily with wide circulation language at a place where registered office of the company is situated. (d) One regional language daily with wide circulation at the place of the stock exchange where the maximum volume of trading in the shares of the target company is recorded during the sixty trading days preceding the date of the public announcement.

14(4)	Detailed Public Statement		A copy of 'Detailed Public Statement shall be sent to followings: (a) Board (b) All the stock exchanges in which the shares of the target company are listed (c) The target company at its registered office

Contents of Public announcement (Regulation 15)

The public announcement shall contain such information as may be specified, including the following,—

(a) name and identity of the acquirer and persons acting in concert with him;

(b) name and identity of the sellers, if any;

(c) nature of the proposed acquisition such as purchase of shares or allotment of shares, or any other means of acquisition of shares or voting rights in, or control over the target company;

(d) the consideration for the proposed acquisition that attracted the obligation to make an open offer for acquiring shares, and the price per share, if any;

(e) the offer price, and mode of payment of consideration; and

(f) offer size, and conditions as to minimum level of acceptances, if any.

(3) The detailed public statement pursuant to the public announcement shall contain such information as may be specified in order to enable shareholders to make an informed decision with reference to the open offer.

(4) The public announcement of the open offer, the detailed public statement, and any other statement, advertisement, circular, brochure, publicity material or letter of offer issued in relation to the acquisition of shares under these regulations shall not omit any relevant information, or contain any misleading information.

Filing Draft Letter of offer

Within 5 working days of publication Detailed Public Statement, the acquirer through the manager to the offer is required to file a draft letter of offer with SEBI for its observations.

The Board shall give its comments on the draft letter of offer as expeditiously as possible but not later than fifteen working days of the receipt of the draft letter of offer and in the event of no comments being issued by the Board within such period, it shall be deemed that the Board does not have comments to offer:

Provided that in the event the Board has sought clarifications or additional information from the manager to the open offer, the period for issuance of comments shall be extended to the fifth working day from the date of receipt of satisfactory reply to the clarification or additional information sought.

Provided further that in the event the Board specifies any changes, the manager to the open offer and the acquirer shall carry out such changes in the letter of offer before it is dispatched to the shareholders.

Takeover Tactics and Strategies

Corporate takeovers may be classified under three broad classes:

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

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

Hostile Takeover : Mechanism
Tender offer and proxy fight are the two primary methods of conducting a hostile takeover. A tender **offer** is a public bid for a large chunk of the target stock at a fixed price which is higher than the current market value of the stock. The offer has a time limit and it may have other provision that the target company must abide to if shareholders accept the offer. The bidding company must disclose their plans for the target company and file relevant document as required under SEBI Takeover regulations. In a **proxy fight**, the buyer does not attempt to buy shares of the target company. Instead, they try to convince the shareholders to vote out current management/board in favour of a team that will approve the takeover. Proxy refers to the shareholders' ability to let someone else make their note for them, that is the buyer notes for the new board by proxy.

Swaraj Paul's Hostile Bid for Escorts and DCM
In 1980s, London-based NRI Swaraj Paul made a hostile bid to control the management of two Indian companies, Escorts Limited and DCM (Delhi Cloth Mills) Limited by picking up their shares from the stock market. This had created lot of ripples in the Indian cor-porate sector and widely reported in the media. But he had to face major obstacles from government-run financial institutions. The Life Insurance Corporation opposed this hostile bid and supported the two distressed companies. The two companies refused to register the transfer of shares in his name. Promoters of the two companies - the Nanda and Shri Ram families - also used their political links to defeat the hostile bid of Paul. Though Swaraj Paul failed to fulfil his dream of controlling Escorts and DCM, but was successful in highlight-ing how particular families were able to exercise managerial control over large corporate entities despite holding a minuscule proportion of the concerned company's shares

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

Companies Act Provisions

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

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

Takeover of Listed Companies

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

Section 235 of the Companies Act, 2013 & takeovers

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

The facts of the Case: A company C engaged in the cellular telephony business had two groups of shareholders - the T group holding about 92 per cent and the A group holding the rest. The T group formed a new company in which it held 99.99 per cent (company “O”). Thereafter, company O made an offer to buy out the shares of the company C. It relied on the provisions of section 235. Thus, it was stated in the offer that if offers were received for shares constituting 90 per cent or more of the capital of C, then the remaining shares would be acquired at the same price. There was another related issue of giving proper notice as required by section 235 which was also given due importance but there was an important substantive question. Can the provisions of section 235 apply in such a case? Essentially, the scheme can be summarised as follows.

There can be an offer to takeover a company which offer would be addressed to its shareholders. It may so happen that 90 per cent or more of the shareholders have agreed to the offer but the rest of the shareholders do not agree to it. In such a case, of course, the offeror can acquire the 90 per cent plus shares offered and live with the remaining shareholders. However, what if he does not wish the remaining shareholders to continue? On the other hand, what if the offeror has offered to acquire only from a group holding 90 per cent or more shares and not offered to the remaining shareholders and in such a situation these 10 per cent or less shareholders want the offer to buy their shares also? It is provided under section 235 that if the offeror wishes, he can compulsorily acquire the shares of the remaining shareholders on the same terms.

In the other situation, the remaining shareholders can also require the offeror to acquire their shares. Now, in the first situation, the provision would appear to be drastic and involving expropriation. Also, it may be capable of misuse in the sense that it could be used to eliminate certain minority shareholders by acquiring their shares at a nominal value.

Acquisitions under section 235 did sound as acts of expropriation but there was a certain logic to it. If 90 per cent of the shareholders were in favour of a scheme, it would not be fair if the remaining small group held back its approval thus blocking it. The motives may be mala fide. As the Court observed, “In my opinion, it is not legally odious to expect to fall in line with the dictates of the overwhelming majority comprising ninety per cent of the group. Usually, there is wisdom in the strength of numbers.

There is every possibility that where nine persons are willing to accept a particular offer, the remaining single person may be standing apart from the others for motives which are not mercantile or commercial”. However, it was very important that for such an act to be allowed, it was a fair and bona fide one. The Court very importantly held that the same group that was in the majority could not use to remove the small majority under this provision. It was very essential that an independent person or group should be the offeror which was not so in the present case.

In fact, the court held that “it was this very reason the section is deemed to be constitutional and if this was deviated from, it would amount to violation of fundamental rights and thus be struck down”. The Court rejected the proposal.

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

Takeover Bids

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

Types of Takeover Bids

Takeover bids may be a

(i) mandatory

(ii) voluntary

(iii) competitive

(iv)conditional.

Mandatory Bid

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

Under Regulation 3(2) no acquirer, who together with persons acting in concert with him, has acquired and holds in accordance with these regulations shares or voting rights in a target company entitling them to exercise twenty-five per cent or more of the voting rights in the target company but less than the maximum permissible non-public shareholding, shall acquire within any financial year additional shares or voting rights in such target company entitling them to exercise more than five per cent of the voting rights, unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations: Provided that such acquirer shall not be entitled to acquire or enter into any agreement to acquire shares or voting rights exceeding such number of shares as would take the aggregate shareholding pursuant to the acquisition above the maximum permissible non-public shareholding. The New Takeover Code of 2011, now mandates an acquirer to place an offer for at least 26% of the 'total shares of the target company', as on the '10th working day from the closure of the tendering period'.

Voluntary Bid

A concept of voluntary Bid has been introduced in the Takeover Code of 2011, by which an acquirer who holds more than 25% but less than the maximum permissible limit, shall be entitled to voluntarily make a public announcement of an open offer for acquiring additional shares subject to their aggregate shareholding after completion of the open offer not exceeding the maximum permissible non-public shareholding. Such voluntary offer would be for acquisition of at least such number of shares as would entitle the acquirer to exercise an additional 10% of the total shares of the target company. This would facilitate the substantial shareholders and promoters to consolidate their shareholding in a company.

Competitive Bid

Competitive offer is an offer made by a person, other than the acquirer who has made the first public announcement. A competitive offer shall be made within 15 working days of the date of the Detailed Public Statement (DPS) made by the acquirer who has made the first PA. If there is a competitive offer, the acquirer who has made the original public announcement can revise the terms of his open offer provided the revised terms are favourable to the shareholders of the target company. Further, the bidders are entitled to make revision in the offer price up to three working days prior to the opening of the offer. The schedule of activities and the offer opening and closing of all competing offers shall be carried out with identical timelines.

Conditional Bid

A bid in which the acquirer has stipulated a minimum level of acceptance is known as a ‘conditional bid’. ‘Minimum level of acceptance’ implies minimum number of shares which the acquirer desires under the said conditional offer. If the number of shares validly tendered in the conditional offer, are less than the minimum level of acceptance stipulated by the acquirer, then the acquirer is not bound to accept any shares under the offer. In a conditional offer, if the minimum level of acceptance is not reached, the acquirer shall not acquire any shares in the target company under the open offer or the Share Purchase Agreement which has triggered the open offer.

Defensive Tactics and Strategies

Antitakeover defenses allow you to protect your company from hostile takeovers.Ever wondered how to protect your company from a hostile takeover? There are plenty of options for you to choose from.

This secion introduces takeover techniques and defenses.

Analyzing various antitakeover defenses, the section emphasizes the ones that are most successful in protecting corporate interests.It also points out certain issues in defenses that may affect the interests of shareholders.

Hostile Takeover Issues

Hostile corporate takeovers and defenses against them have long been of great interest to legal scholars, attorneys, and other professionals all over the world. This interest can be seen in the enormous amount of literature on hostile takeovers and corresponding defenses.

All of the court opinions, statutes, books, articles, and other materials indicate the magnitude of issues in this complex area of corporate law.

It is apparently impossible to cover most of such issues within one article. It, therefore, concentrates on the most important issue forming the basis of many other issues in the takeover area.

The major issue is whom to defend and how. Who to defend specifically refers to whether shareholders or directors are the main corporate constituency. How to defend refers to which mechanisms should ensure the interests of the primary corporate constituency.

Antitakeover Responsibility

This section answers the above questions in favor of shareholders.

It, particularly, argues for a higher standard of responsibility of directors undertaking antitakeover actions.

The main point of this section is that, in order to protect the interests of shareholders better, the responsibility of directors in the antitakeover actions should be higher.

This objective can be accomplished by elevating the level of scrutiny of the directors' antitakeover activity from the enhanced scrutiny to a strict scrutiny.

Such an improvement is expedient to increase the directors' accountability to the corporation and its shareholders.

It would serve the best interests of the main corporate constituency, *i.e.*, the shareholders. Implementation of this approach would generally improve the corporate governance law and practice.

Corporate Takeovers
Corporate takeovers can generally be either friendly or hostile.

This section focuses specifically on the hostile takeovers. They raise more problems than friendly, negotiated ones. A takeover is hostile when the target's management opposes an acquirer's effort to gain control of the target. Since the hostile takeovers normally happen with regard to public corporations, this type of entity is the subject of analysis in this section.

Having decided to acquire a target, the acquirer usually deals with either of the two main corporate constituencies of the target: management or shareholders. In a negotiated takeover, the acquirer deals with the management, while, in a hostile takeover, the acquirer deals with the shareholders.

A possibility or threat of a hostile takeover causes the target's board to adopt and implement antitakeover defenses. The main problem with such antitakeover activity is who to protect first and how.

Courts normally seek to strike a balance between the interests of shareholders and managers. As this section demonstrates, however, the courts occasionally failed to reach this balance. The courts, namely, often protected managers at the expense of shareholders.

In the past, shareholder displeasure with the corporate governance had forced such large companies as Pfizer, Bristol-Myers Squibb, Aetna, Omnicom, Coca-Cola, CSX, Hewlett-Packard, and others to weaken their antitakeover defenses. Nevertheless, nearly all exchange-listed companies used to have at least one significant anti-takeover provision, with many of them having adopted shareholder rights plans.

Hostile Takeovers

The acquirers usually employ the following hostile takeover techniques:

- **Toehold acquisition** –
  a purchase of the target's shares on an open market. They allow the acquirer to become a shareholder of the target and provide an opportunity to sue the target later on if the takeover attempt turns out unsuccessful.

- **Tender offer** –
  an acquirer's offer to the target's shareholders to buy their shares at a premium over the market price. A partial, two-tier, front-end loaded tender offer usually involves a back-end merger. The takeover literature generally treats tender offer as

a hostile takeover technique. It should not be treated as hostile, however, if it favors the interests of the majority of shareholders. Such a majority should be adequate to approve the relevant merger or acquisition. To claim that any tender offer is hostile would make virtually any merger or acquisition hostile.

- **Proxy fight** –
  a solicitation of the shareholders' proxies to vote for insurgent directors. Proxy fights can run along with "board packing," where the number of board members increases and the acquirer intends to fill this increase with his slate of directors.

Numerous takeover terms may seem to be informal. The courts, nevertheless, widely use these terms and hence make them appropriate in legal literature.

For instance, "in the modern takeover lexicon, it is consistently recognized that defensive measures which are either preclusive or coercive are included within the common definition of draconian," according to the landmark case of *Unitrin, Inc. v. American General Corp*.

Alongside, the board of directors is "the defender of the metaphorical medieval corporate bastion," and can act "defensively before a bidder is at the corporate bastion's gate."

Notably, the judicial use of these terms makes this area of law more interesting and engaging.

Antitakeover Defenses
In response to these hostile takeover techniques, targets usually devise the following defenses:

1. Stock repurchase
Stock repurchase (aka self-tender offer) is a purchase by the target of its own-issued shares from its shareholders. This is an effective defense that successfully passed such prominent antitakeover defense cases as *Unitrin* and *Unocal v. Mesa Petroleum Co.*

2. Poison pill
Poison pill (aka shareholder rights plan) is a distribution to the target's shareholders of the rights to purchase shares of the target or the merging acquirer at a substantially reduced price.

What triggers an execution of these rights is an acquisition by an acquirer of certain percentage of the target's shareholding.

If exercised, these rights can considerably dilute the acquirer's shareholding in the target and thus can deter a takeover.

The poison pill is one of the most powerful defenses against hostile takeovers.

The pills can be

1. flip-in, flip-over,
2. dead hand, and
3. slow/no hand.

- Flip-in poison pill can be “chewable,” which means that the shareholders may force a pill redemption by a vote within a certain timeframe if the tender offer is an all-cash offer for all of the target’s shares. The poison pill can also provide for a window of redemption. That is a period within which the management can redeem the pill. This window hence determines the moment when the management’s right to redeem terminates.

- “Dead hand” pill creates continuing directors. These are current target’s directors who are the only ones that can redeem the pill once an acquirer threatens to acquire the target. While the earlier court decisions restricted use of dead hand and no hand pills, the more recent decisions uphold such pills.

- “No hand” (aka “slow hand”) pill prohibits redemption of the pill within a certain period of time, for example six months.

3. Staggered board
Staggered board is a board in which only a certain number of directors, usually one third, is reelected annually. It is a powerful antitakeover defense, which might be stronger than is commonly recognized. For the reason of being too strong and reducing returns to the target’s shareholders, the latter happened to resist this type of defense.

4. Shark repellants
Shark repellants are certain provisions in the target’s charter or bylaws deterring an acquirer’s desirability of a hostile takeover. This defense typically involves a supermajority vote requirement regarding a merger of the target with its majority shareholder. This defense also includes other takeover deterrent provisions in the target’s certificate of incorporation or bylaws.

5. Golden parachutes
Golden parachutes are additional compensations to the target’s top management in the case of termination of its employment following a successful hostile acquisition. Since these compensations decrease the target’s assets, this defense reduces the amount the acquirer is willing to pay for the target’s shares. This defense may thus harm shareholders. It, however, effectively deters hostile takeovers.

6. Greenmail
Greenmail is a buyout by the target of its own shares from the hostile acquirer with a premium over the market price, which results in the acquirer’s agreement not to pursue obtaining control of the target in the near future. The taxation of greenmail used to present a considerable obstacle for this defense. Plus, the statute may require a shareholder approval of repurchase of a certain amount of shares at a premium.

7. Standstill agreement
Standstill agreement is an undertaking by the acquirer not to acquire any more shares of the target within certain period of time. A standstill agreement is an additional defense that usually accompanies the greenmail described above.

8. Leveraged recapitalization
Leveraged recapitalization (aka corporate restructuring) is a series of transactions designed to affect the equity and debt structure of a corporation. Recapitalization usually involves such transactions as

(i) sale of assets,
(ii) issuance of debt, and
(iii) distribution of dividends.

9. Leveraged buyout
Leveraged buyout is a purchase of the target by the management with the use of debt financing. This defense burdens the target with the debt. In such a case, the management becomes a bidder and competes with a hostile acquirer for control over the target.

10. Crown jewels
Crown jewels are options under which a favored party can buy a key part of the target at a price that may be less than its market value.

11. Scorched earth
Scorched earth is a self-tender offer by the target that burdens the target with debt.

12. Lockups
Lockups are defensive mechanisms in friendly mergers and acquisitions designed to deter hostile bids. The lockups include

(i) no-shop covenant,
(ii) termination/bust-up fee,
(iii) option to buy a subsidiary,
(iv) expense reimbursement etc.

13. Pacman
Pacman is a target's tender offer for the acquirer's shares.

14. White knight
White knight is a strategic merger that does not involve a change of control and relieves the target's management of the responsibility to seek the best price available. An example is the case of *Paramount Communications, Inc. v. Time Inc.*

15. White squire
White squire is giving by the target to a friendly party of a certain ownership in the target. This defense is effective against acquisition by the hostile party of a complete control over the target by "freezing out" of minority shareholders.

16. Change of control provisions
Change of control provisions is target's contractual arrangements with third parties that burden the target in the case of a change in its control.

17. "Just say no"
On top of all, the "just say no" approach is a board's development and implementation of a long-term corporate strategy which enables the board simply to reject a proposal of any

potential acquirer who would fail to prove that his acquisition strategy matches that of the target.

This list is non-exhaustive.

The variety of defenses shows that the possibilities and, consequently, the power of directors in responding to hostile takeovers are virtually unlimited. Some defenses are more effective than others. Not all of them are necessarily "show-stoppers", nevertheless. One example, a golden parachute may decrease the price that the acquirer would be willing to pay for the target, but it may not necessarily stop the hostile acquisition. Another example, a poison pill can easily lose its effect if the acquirer wins a proxy fight for the target and then redeems the pill.

The above hostile takeover techniques and defenses show the unlimited scope of power that the board enjoys in its antitakeover activity. The more power requires the higher degree of responsibility therefore.

FAQs on SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS) REGULATIONS, 2011

*These FAQs offer only a simplistic explanation/clarification of terms/concepts related to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ["**SAST Regulations, 2011**"]. Any such explanation/clarification that is provided herein should not be regarded as an interpretation of law nor be treated as a binding opinion/guidance from the Securities and Exchange Board of India ["**SEBI**"]. For full particulars of laws governing the substantial acquisition of shares and takeovers, please refer to actual text of the Acts/Regulations/Circulars appearing under the Legal Framework Section on the SEBI website.*

1. **Please provide details as to how the regulatory framework governing Takeovers has evolved over a period?**

    - The earliest attempts at regulating takeovers in India can be traced back to the 1990s with the incorporation of Clause 40 in the Listing Agreement.
    - While, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994 which were notified in November 1994 made way for regulation of hostile takeovers and competitive offers for the first time; the subsequent regulatory experience from such offers brought out certain inadequacies existing in those Regulations. As a result, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 were introduced and notified on February 20, 1997, pursuant to repeal of the 1994 Regulations.
    - Owing to several factors such as the growth of Mergers & Acquisitions activity in India as the preferred mode of restructuring, the increasing sophistication of takeover market, the decade long regulatory experience and various judicial pronouncements, it was felt necessary to review the Takeover Regulations 1997. Accordingly, SEBI formed a Takeover Regulations Advisory Committee (TRAC) in September 2009 under the Chairmanship of (Late) Shri. C. Achuthan, Former Presiding Officer, Securities Appellate Tribunal (SAT) for this purpose. After extensive public consultation on the report submitted by TRAC, SEBI came out with the SAST Regulations 2011

which were notified on September 23, 2011. The Takeover Regulations, 1997 stand repealed from October 22, 2011, i.e. the date on which SAST Regulations, 2011 come into force.

2. What is the significance of the notification related to SAST Regulations, 2011 published on September 23, 2011?

Vide the said notification dated September 23, 2011, the SAST Regulations, 2011 were notified to replace SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, since repealed..

SAST Regulations, 2011 come into force with effect from October 22, 2011. SAST Regulations, 2011 are available on SEBI's website under the section legal framework.

3. When the Takeover Regulations, 2011 have come in to force?

October 22, 2011 i.e. 30th day from the date of notification. (September 23, 2011 i.e. date of notification has been taken as the first day for computing 30 days).

4. What is meant by Takeovers & Substantial acquisition of shares?

When an "acquirer" takes over the control of the "Target Company", it is termed as Takeover. When an acquirer acquires "substantial quantity of shares or voting rights" of the Target Company, it results into substantial acquisition of shares.

5. Who is an 'Acquirer'?

Acquirer means any person who, whether by himself, or through, or with persons acting in concert with him, directly or indirectly, acquires or agrees to acquire shares or voting rights in, or control over a target company. An acquirer can be a natural person, a corporate entity or any other legal entity.

6. What is meant by Persons acting in Concert or 'PAC' in the context of SAST Regulations, 2011?

PACs are individual(s)/company (ies) or any other legal entity (ies) who, with a common objective or purpose of acquisition of shares or voting rights in, or exercise of control over the target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company.

SAST Regulations, 2011 define various categories of persons who are deemed to be acting in concert with other persons in the same category, unless the contrary is established.

7. What is a 'Target Company'?

The company / body corporate or corporation whose equity shares are listed in a stock Exchange and in which a change of shareholding or control is proposed by an acquirer, is referred to as the 'Target Company'.

8. What is an open offer under the SAST Regulations, 2011?

An open offer is an offer made by the acquirer to the shareholders of the target company inviting them to tender their shares in the target company at a particular price. The primary purpose of an open offer is to provide an exit option to the shareholders of the target company on account of the change in control or substantial acquisition of shares, occurring in the target company.

9. Under which situations is an open offer required to be made by an acquirer?

If an acquirer has agreed to acquire or acquired control over a target company or shares or voting rights in a target company which would be in excess of the threshold limits, then the acquirer is required to make an open offer to shareholders of the target company.

10. Can the acquisitions, resulting from any agreement attracting the obligation to make an open offer, be completed by way of transactions settled on stock exchange such as bulk/block deals?

No. Regulation 22(1) of Takeover Regulations 2011 specifically provides that the acquirer shall not complete the acquisition of shares and voting rights in, or control over, the target company, whether by way of subscription of shares or a purchase of shares attracting the obligation to make an open offer for acquiring shares, until the expiry of the offer period.

In cases where acquisitions, resulting from any agreement triggering open offer are sought to be completed through transactions such as bulk/ block deals, settled on a recognized stock exchange, the same would get completed/ settled on T+2 basis i.e. within 2 days after the date of such transaction. Therefore such acquisitions, if done, will not be in line with the provisions of Regulation 22(1) since the same would result in completion of the triggering acquisition before the expiry of the offer period. Hence the acquisition resulting from any agreement attracting the obligation to make an open offer cannot be executed through transactions such as block/ bulk deal.

11. What are the threshold limits for acquisition of shares / voting rights, beyond which an obligation to make an open offer is triggered?

- **Acquisition of 25% or more shares or voting rights:** An acquirer, who (along with PACs, if any) holds less than 25% shares or voting rights in a target company and agrees to acquire shares or acquires shares which along with his/ PAC's existing shareholding would entitle him to exercise 25% or more shares or voting rights in a target company, will need to make an open offer before acquiring such additional shares.

- **Acquisition of more than 5% shares or voting rights in a financial year:** An acquirer who (along with PACs, if any) holds 25% or more but less than the maximum permissible non-public shareholding in a target company, can acquire additional shares in the target company as would entitle him to exercise more than 5% of the voting rights in any financial year ending March 31, only after making an open offer.

12. How is the maximum permissible non-public shareholding in a listed company defined?

Maximum permissible non-public shareholding is derived based on the minimum public shareholding requirement under the Securities Contracts (Regulations) Rules 1957 ("**SCRR**"). Rule 19A of SCRR requires all listed companies (other

than public sector companies) to maintain public shareholding of at least 25% of share capital of the company. Thus by deduction, the maximum number of shares which can be held by promoters
i.e. Maximum permissible non-public shareholding) in a listed companies (other than public sector companies) is 75% of the share capital.

13. What is the basis of computation of the creeping acquisitions limit under Regulation 3(2) of Takeover Regulations 2011?

For computing acquisitions limits for creeping acquisition specified under regulation 3(2), gross acquisitions/ purchases shall be taken in to account thereby ignoring any intermittent fall in shareholding or voting rights whether owing to disposal of shares or dilution of voting rights on account of fresh issue of shares by the targetcompany.

14. Whether for the purpose of the creeping acquisition in terms of the Takeover Regulations, 2011, the Creeping Acquisition made during the period 01.04.2011 to 22.10.2011 will be considered?

The Takeover Regulations, 2011 have clearly defined the financial year as the period of 12 months commencing on the first day of the month of April.
Thus, for the purpose of the creeping acquisitions under Regulation 3(2) of Takeovers Regulations 2011, shares acquired during 1/4/2011 to 22/10/2011 will be taken in to account.

15. Whether hostile offers/bids are permitted under the new regulations?

There is no such term as hostile bid in the regulations. The hostile bid is generally understood to be an unsolicited bid by a person, without any arrangement or MOU with persons currently in control.

Any person with or without holding any shares in a target company, can make an offer to acquire shares of a listed company subject to minimum offer size of 26%.

16. What is a voluntary open offer?

A voluntary open offer under Regulation 6, is an offer made by a person who himself or through Persons acting in concert ,if any, holds 25% or more shares or voting rights in the target company but less than the maximum permissible non-public shareholding limit.

17. What are the restrictions on acquirers making a voluntary open offer?

A voluntary offer cannot be made if the acquirer or PACs with him has acquired any shares of the target company in the 52 weeks prior to the voluntary offer. The acquirer is prohibited from acquiring any shares during the offer period other than those acquired in the open offer. The acquirer is also not entitled to acquire any shares for a period of 6 months, after completion of open offer except pursuant to another voluntary open offer.

18. Can a person holding less than 25% of the voting rights/ shares in a target company, make an offer?

Yes, any person holding less than 25% of shares/ voting rights in a target company can make an open offer provided the open offer is for a minimum of 26% of the share capital of the company.

19. **How is the voluntary offer made by a person holding less than 25% of shares/ voting rights in a target company different from the voluntary offer made by a person holding more than 25% of shares/ voting rights of the target company?**

Voluntary offer by a person holding less than 25%	**Voluntary offer by a person holding more than 25%**
Minimum offer size of 26%.	Minimum offer size of 10%.
Maximum can be for entire share capital of the target company.	The maximum offer size is linked to maximum permissible non public shareholding permitted under Securities Contracts (Regulations) Rules 1957.
No such conditions	• Acquirer should not have acquired any shares during 52 weeks period prior to Public Announcement. • Acquirer is not entitled to acquire any shares of the target company for a period of 6 months after the completion of the open offer except for a voluntary open offer.

20. **Proposed acquisition of which type of securities, beyond the stipulated thresholds, leads to an obligation of making an open offer?**

Acquisition of equity shares carrying voting rights or any security which entitles the holder thereof to exercise voting rights, beyond the prescribed threshold limits, leads to the obligation of making an open offer. GDR (Global Depository Receipts) which by virtue of depository agreement or otherwise, carrying voting rights is an example of a security which entitles the holder to exercise voting rights but is not an equity share.

21. **Do all acquisitions of shares in excess of the prescribed limits and / or control lead to an open offer?**

No. In respect of certain acquisitions, SAST Regulations, 2011 provide exemption from the requirements of making an open offer, subject to certain conditions being fulfilled. For example, acquisition pursuant to inter- se transfer of shares between certain categories of shareholders; acquisitionin the ordinary course of business by entities like Underwriter registered with SEBI, stock brokers, merchant bankers acting as stabilizing agent, Scheduled Commercial Bank (SCB), acting as an escrow agent; etc. For more details, please refer to regulation 10 of SAST Regulations, 2011.

22. **Does SEBI have the power to grant exemption to an acquirer from making an open offer or grant relaxation from the strict compliance with prescribed provisions of the open offer process, even if the proposed acquisition of shares or control is not covered under the**

exemptions prescribed in SAST Regulations,2011?

Yes. In the interest of the securities market, upon an application made by the acquirer, SEBI has the power to grant exemption from the requirements of making an open offer or grant a relaxation from strict compliance with prescribed provisions of the open offerprocess.

Before undertaking such acquisition, SEBI may at its discretion refer the application to a panel of experts constituted by SEBI. The orders passed in such matters would be uploaded on SEBI's website.

23. Do only direct acquisitions of shares or control of the target company lead to the requirement of making an open offer?

No. The requirement to make an open offer arises even if there is an indirect acquisition of shares and / or control of the target company. An indirect acquisition would be the acquisition of shares or control over another entity by an acquirer that would enable the acquirer to exercise or direct to exercise voting rights beyond the stipulated thresholds or control over the target company.

23A.**How are the thresholds for the requirement of making an open offer in case of an indirect acquisition computed?**

The thresholds for the requirement of making an open offer in case of an indirect acquisition are computed on the basis of the voting rights and/or control acquired in the target company. Further, the quantum of acquisition of the target company in case of an indirect acquisition cannot be computed on a pro rata basis. This is illustrated as below:

- If X acquires 40% shares of Y along with majority control of Y which, in turn, holds 70% shares of Z, a listed company along with majority control of Z, then X, in effect, acquires control on 70% shares of Z held by Y. Therefore, X will be required to make an open offer for the shareholders of Z.
- Now; If X, which already holds 40% shares of Y and majority control of Y, further acquires additional 10% shares of Y, then X, in effect, does not acquire control on any shares additional to 70% shares of Z held by Y. Therefore, X will not be required to make an open offer for the shareholders of Z. It may be noted that the computation of quantum of additional shares acquired by X in Z as 10% of 70%, i.e., 7% on pro rata basis is not correct. Here, X does not acquire any additional shares of Z either directly or indirectly by acquiring additional 10% shares of Y.
- Now; if A and B are in joint control of X which holds majority control of Y which, in turn, holds 70% shares of Z along with its majority control and A acquires sole control of X pursuant to cessation of control of X by B, then A, in effect, acquires sole control of Z indirectly through X and Y. Therefore, X will be required to make an open offer for the shareholders of Z.

24. What is a competitive offer?

Competitive offer is an offer made by a person, other than the acquirer who has made the first public announcement. A competitive offer shall be made within 15 working days of the date of the Detailed Public Statement (DPS) made by the acquirer who has made the first PA.

25. What happens if there is a competitive offer?

If there is a competitive offer, the acquirer who has made the original public announcement can revise the terms of his open offer provided the revised terms are favorable to the shareholders of the target company. Further, the bidders are entitled to make revision in the offer price up to 3 working days prior to the opening of the offer. The schedule of activities and the offer opening and closing of all competing offers shall be carried out with identical timelines.

26. What is a conditional offer?

An offer in which the acquirer has stipulated a minimum level of acceptance is known as a 'conditional offer'.

27. What is meant by the term 'minimum level of acceptance'?

'Minimum level of acceptance' implies minimum number of shares which the acquirer desires under the said conditional offer. If the number of shares validly tendered in the conditional offer, are less than the minimum level of acceptance stipulated by the acquirer, then the acquirer is not bound to accept any shares under the offer.

28. If the minimum level of acceptance is not reached, can the acquirer acquire shares under the Share Purchase Agreement, which triggered the offer?

In a conditional offer, if the minimum level of acceptance is not reached, the acquirer shall not acquire any shares in the target company under the open offer or the Share Purchase Agreement which has triggered the open offer.

29. What is the stipulated size of an open offer?

An open offer, other than a voluntary open offer under Regulation 6, must be made for a minimum of 26% of the target company's share capital. The size of voluntary open offer under Regulation 6 must be for at least 10% of the target company's share capital. Further the offer size percentage is calculated on the fully diluted share capital of the target company taking in to account potential increase in the number of outstanding shares as on 10^{th} working day from the closure of the open offer.

30. What is 'offer price' and can the acquirer revise the offer price?

Offer price is the price at which the acquirer announces to acquire shares from the public shareholders under the open offer. The offer price shall not be less than the price as calculated under regulation 8 of the SAST Regulations, 2011 for frequently or infrequently traded shares.

Acquirer can make an upward revision to the offer price at any time up to 3 working days prior to the opening of the offer.

31. How do you determine whether the shares of the target company are frequently traded or infrequently traded?

The shares of the target company will be deemed to be frequently traded if the traded turnover on any stock exchange during the 12 calendar months preceding the calendar month, in which the PA is made, is at least 10% of the total number of shares of the target company. If the said turnover is less than 10%, it will be deemed to be infrequently traded.

32. How is the offer price calculated in case shares are frequently traded on the stock exchange?

If the target company's shares are frequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement ("SPA") triggering the offer;
- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement ("PA");
- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- Volume weighted average market price for sixty trading days preceding the PA.

33. How is the offer price calculated in case shares are infrequently traded on the stock exchange?

If the target company's shares are infrequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement ("SPA") triggering the offer;
- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement ("PA");
- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- The price determined by the acquirer and the manager to the open offer after taking into account valuation parameters including book value, comparable trading multiples, and such other parameters that are customary for valuation of shares of suchcompanies.

It may be noted that the Board may at the expense of the acquirer, require valuation of shares by an independent merchant banker other than the manager to the offer or any independent chartered accountant in practice having a minimum experience of 10 years.

34. Will the promoter be entitled to non-compete or any other fees other than the offer price?

As per the SAST Regulations, 2011, all shareholders will be given equitable treatment and no Promoter or shareholder can be paid any extra price, by whatever name it may be called.

35. Are there special provisions for determining the offer price in case of open offer arising out of indirect acquisition of a target company?

Yes. Since indirect acquisitions involve acquiring the target company as a part of a larger business, SAST Regulations, 2011 have prescribed additional parameters to be taken into account for determination of the offer price. If the size of the target company exceeds certain thresholds as compared to the size of the entity or business being acquired then the acquirer is required to compute and disclose in the letter of offer, the per share value of the target company taken into account for the acquisition, along with the methodology. (Kindly refer to Regulation 5). Further, in indirect acquisitions which are not in the nature of deemed direct acquisition, the offer price shall stand enhanced by an amount equal to a sum determined at the rate of 10% per annum for the period between the date on which primary acquisition was contracted and the date of Detailed Public Statement.

36. What is the difference between 'offer period' and 'tendering period'?

The term 'offer period' pertains to the period starting from the date of the event triggering open offer till completion of payment of consideration to shareholders by the acquirer or withdrawal of the offer by the acquirer as the case may be.

The term 'tendering period' refers to the 10 working days period falling within the offer period, during which the eligible shareholders who wish to accept the open offer can tender their shares in the open offer.

37. Who are eligible shareholders?

All shareholders of the target company other than the acquirer, persons acting in concert with him and the parties to underlying agreement which triggered open offer including persons deemed to be acting in concert with such parties, irrespective of whether they are shareholders as on identified date or not.

38. What are the typical steps and corresponding timelines, in an open offer process?

Under most scenarios (except in certain types of indirect acquisitions) on the day of the triggering event, the acquirer is required to make a Public Announcement to the stock exchanges where shares of Target Company are listed and to SEBI. Within 5 working days thereafter, the acquirer is required to publish a Detailed Public Statement (DPS) in newspapers and also submit a copy to SEBI, after creation of an escrow account.

Within 5 working days of publication DPS, the acquirer through the manager to the offer is required to file a draft letter of offer with SEBI for its observations. The letter of offer is dispatched to the shareholders of the target company, as on the identified date, after duly incorporating the changes indicated by SEBI, if there are any.

The offer shall open not later than 12 working days from the date of receipt of SEBI's observations. The acquirer is required to issue an advertisement announcing the final schedule of the open offer, one working day before opening of the offer. The offer shall remain open for 10 working days from the date of opening of the offer. Within 10 working days after the closure of the offer, the acquirer shall make payments to the shareholders whose shares have been accepted. A post offer advertisement, giving details of the acquisitions, is required to be published by the acquirer within 5 workings days of the completion of payments under the open offer.

39. What is 'identified date' in the context of SAST Regulations, 2011?

Identified date means the date 10 working days prior to the commencement of the tendering period, for the purposes of determining the shareholders of the target company to whom the letter of offer along with the form of acceptance shall be sent.

40. What is the purpose of the escrow account in the open offer process?

The acquirer is required to deposit some percentage of the offer price, in an escrow account before issuing a Detailed Public Statement. This serves as a security for performance of acquirer's obligations under the open offer.

40A.**Can cash component of the escrow account in the open offer process be maintained in an interest bearing account?**[2]

Yes, the cash component of the escrow account may be maintained in an interest bearing account. However, the merchant banker shall ensure that the funds are available at the time of making payment to shareholders.

41. At what point of time in the process does a Merchant Banker need to be appointed and what is its role in the open offer process?

The Acquirer is required to appoint a Merchant Banker, registered with SEBI, as manager to the open offer before making the PA. The PA is required to be made through the said manager to the open offer.

The manager to the open offer has to exercise due diligence and ensure compliance with SAST Regulations, 2011. The manager to the open offer has to ensure that the contents of the PA, DPS, letter of offer and the post offer advertisement are true, fair and adequate in all material aspects and are in compliance with the requirements of SAST Regulations, 2011. Further, the manager to the open offer has to ensure that the acquirer is able to implement the open offer and firm arrangements for funds through verifiable means have been made by the acquirer to meet the payment obligations under the open offer.

42. What is a letter of offer? Does SEBI approve the draft Letter of Offer?

The letter of offer is a document which is dispatched to all shareholders of the target company as on identified date. This is also made available on the website of SEBI.

Prior to dispatch of letter of offer to shareholders, a draft letter of offer is submitted to SEBI for observations. SEBI may give its comments on the draft letter of offer as expeditiously as possible, but not later than 15 working days of the receipt of the draft letter of offer. SEBI may also seek clarifications and additional information from the manager to the offer and in such a case the period for issuance of comments shall be extended to the fifth working day from the date of receipt of satisfactory reply to the clarifications or additional information sought.

Filing of draft Letter of Offer with SEBI should not in any way be deemed or construed to mean that the same has been cleared, vetted or approved by SEBI. The draft Letter of Offer is submitted to SEBI for the limited purpose of overseeing whether the disclosures contained therein are generally adequate and are in conformity with the Regulations. SEBI does not take any responsibility either for the truthfulness or correctness of any statement, financial soundness of acquirer, or of PACs, or of the Target Company, whose shares are proposed to be acquired or for the correctness of the statements made or opinions expressed in the Letter of Offer.

43. How do I find the status of the draft letter of offer filed with SEBI?

SEBI updates the processing status of draft letter of offers filed with it on its website on a periodic basis under the section "offerdocuments".

44. What are the disclosures required under the Public Announcement?

Public Announcement contains minimum details about the offer, the transaction that triggered the open offer obligations, acquirer, selling shareholders (if any), offer price and mode of payment. SEBI has prescribed format of Public Announcement, which is available in the SEBI website.

45. What are the disclosures required under the Detailed Public Statement?

Detailed Public Statement contains disclosure in more detail about the acquirer/PACs, target company, financials of the acquirers/PACs/target company, the offer, terms & conditions of the offer, procedure for acceptance and settlement of the offer, escrow account etc. SEBI has prescribed the format for Detailed Public Statement. The same is available in the SEBI website.

46. What are the disclosures required under the Letter of offer?

Letter of offer contains details about the offer, background of Acquirers/PACS, financial statements of Acquirer/ PACs, escrow arrangement, background of the target company, financial statements of the target company, justification for offer price, financial arrangements, terms and conditions of the offer, procedure for acceptance and settlement of the offer. SEBI has prescribed the format for Letter of offer, which enumerates minimum disclosure requirements. The Manager to the offer/ acquirer is free to add any other disclosures which in his opinion are material for the shareholders. The format is available in the SEBI website.

47. Is the financial disclosure standard as outlined in the Format for Detailed Public Statement (DPS) to the Shareholders of the Target Company (TC) in terms of Regulation 15(2)in point I(A) applicable to PACs too since the above clause refers just to the Acquirer ?

Yes, as clearly indicated in the format, the details of financial disclosure are required to be given for the acquirer as well Persons acting in concert with Acquirers.

48. If an acquirer enters into a SPA and triggers an open offer, when can the acquirer acquire shares proposed to be transferred under the SPA?

The acquirer can acquire shares under the SPA only after payment in respect of shares accepted under the open offer is complete but not later than 26 weeks from the expiry of the offer period.

49. What is the role of the target company in the open offer process?

- Once a PA is made, the board of directors of the Target Company is expected to ensure that the business of the target company is conducted in the ordinary course. Alienation of material assets, material borrowings, issue of any authorized securities, announcement of a buy- back offer etc. is not permitted, unless authorized by shareholders by way of a special resolution by postal ballot.
- The target company shall furnish to the acquirer within two working days from

the identified date, a list of shareholders and a list of persons whose applications, if any, for registration of transfer of shares, in case of physical shares, are pending with the targetcompany.

- After closure of the open offer, the target company is required to provide assistance to the acquirer in verification of the shares tendered for acceptance under the open offer, in case of physical shares.
- Upon receipt of the detailed public statement, the board of directors of the target company shall constitute a committee of independent directors to provide reasoned recommendations on such open offer, and the target company shall publish such recommendations and such committee shall be entitled to seek external professional advice at the expense of the target company. The recommendations of the Independent Directors are published in the same newspaper where the Detailed Public Statement is published by the acquirer and are published at least 2 working days before opening of the offer. The recommendation will also be sent to SEBI, Stock Exchanges and the Manager to theoffer.

50. What is the manner in which the acquirer decides the acceptances from each shareholder?

The registrar to the open offer validates all the tenders in the open offer and creates a basis of acceptance in consultation with the manager to the open offer detailing validly and invalidly tendered shares received in the open offer.

In case, the valid shares tendered are less than the offer size, all the valid tendered shares are accepted. If the validly tendered shares in the open offer are more than the offer size, then the valid tenders are accepted on a proportionate basis. This is illustrated asbelow:

The company has a paid up share capital of Rs, 10,000/- (1000 shares of Rs. 10/- each) and shareholder A is holding 50 shares totaling to Rs. 500. In case an open offer is made for 26% of the share capital and the shares tendered are 300 which are in excess of the 26% shareholding, the shares will be accepted by the acquirer on a proportionate basis.

No of shares of A accepted = ((total no of shares offered X (no of shares
in the open offer) tendered by A
))

(Total shares tendered in
the Open offer by all investors)

$$= \frac{260}{300} \times 50 = 43.33 \text{ shares} \sim 43 \text{ shares}$$

Shares which are invalid or are rejected due to the valid acceptances being more than the offer size are subsequently returned to the respective shareholders within 10 working days of the closure of the open offer.

51. What are the modes of payment under the open offer?

Payment considerations by the acquirer under the open offer can be made by cash and / or by issue of equity shares and / or secured debt instruments (investment grade) and / or convertible debt instruments (convertible to equity shares) of acquirer (or PACs, if any) if such equity shares and secured debt instruments are listed.

The chosen mode of payment is required to be disclosed in the open offer document meant for shareholders of the target company.

52. Can an acquirer withdraw the open offer once made?

An open offer once made cannot be withdrawn except in the following circumstances:

- Statutory approvals required for the open offer or for effecting the acquisitions attracting the obligation to make an open offer have been refused subject to such requirement for approvals having been specifically disclosed in the DPS and the letter of offer;
- Any condition stipulated in the SPA attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, subject to such conditions having been specifically disclosed in the DPS and the letter of offer;
- Sole acquirer being a natural person has died;
- Such circumstances which in the opinion of SEBI merit withdrawal of open offer.

53. If post open offer the shareholding of the acquirer goes beyond the maximum permissible non-public shareholding limit, can the acquirer immediately make a delisting offer in terms of Delisting Regulations. ?

No. The acquirer cannot launch a voluntary delisting offer in terms of Delisting Regulations of SEBI, unless a period of twelve months has elapsed from the date of the completion of the offer period.

54. I was not holding shares on the identified date but acquired shares subsequently. Am I eligible to participate in the open offer?

Yes. Shareholders who acquire shares after the identified date are eligible to participate in the open offer provided they submit their valid tenders before the end of the tendering period.

You may send a request to the registrar to the open offer or manager to the open offer for obtaining the letter of offer including the form of acceptance. Alternately, you can make an application on plain paper giving certain specific details. Please refer to the Detailed Public Statement of the acquirer for instructions in this regard.

55. How will shareholder of the target company know that an open offer is made by the acquirer?

SAST Regulations, 2011 provides for wide dissemination of the information related to an open offer. The DPS and pre-offer announcements before commencement of the tendering period are published in national newspapers as well as in one newspaper of the regional language of the place where registered office of the target company is located.

The final letter of offer is required to be dispatched to all shareholders whose names appear as shareholders as on the identified date. Further, the PA, the DPS and other announcements are also filed with the stock exchange and SEBI, and are uploaded on their respective websites for information dissemination.

56. For how many days is an open offer required to be kept open?

The offer is required to be kept open for ten working days.

57. How do I get the Letter of Offer and tender my shares under the open offer?

The letter of offer along with form of acceptance is sent to all eligible shareholders of the target company, who are shareholders of the target company as on the identified date. The eligible shareholder has to fill in the form of acceptance sent along the letter of offer and submit the same to the registrar to the open offer or the manager to the open offer. In case the shareholder has not received the letter of offer, such shareholder can request the registrar to the open offer or manager to the open offer for the same. Further, the letter of offer along with the form of acceptance will also be available on SEBI's website.

58. What are the documents that the shareholders should go through before tendering their shares pursuant to the open offer?

Before tendering their shares pursuant to the open offer, the shareholders are advised to go through the Detailed Public Statement, Letter of offer and also the recommendations and observations of the Committee of Independent Directors on the offer. It may be noted that all the aforesaid documents are available on SEBI website. Further the recommendations of the Independent Directors are published in the same newspaper where the Detailed Public Statement is published by the acquirer and are published at least 2 working days before opening of the offer.

59. Do I need to convert my physical shares into demat before tendering in the open offer?

Shareholders need not convert their physical shares into demat form before tendering shares in the open offer. Physical shares can be tendered in an open offer along with the form of acceptance and such documents as mentioned in the section 'Procedure for acceptance and settlement of the Offer' in the letter of offer.

60. Can I withdraw or revise my tender?

No. Once a shareholder has tendered his shares in the open offer made by the acquirer, he/ she cannot withdraw/ revise his/her request.

61. Can I tender my shares after the closure of the tendering period?

No. Your acceptance for tendering shares in the offer should reach the collection center on or before the last date of tendering period.

62. I hold shares which are partly paid-up. Can I tender these shares in the open offer?

Yes, partly paid-up shares can be tendered in the open offer. The letter of offer contains the offer price of the partly paid up share, which can be different from the offer price for fully paid up share.

63. When will the shareholder receive (i) intimation about acceptance/ rejection of his shares tendered under the open offer or (ii) consideration for shares accepted by the acquirer?

The shareholder shall receive (i) intimation about acceptance/ rejection of his shares tendered under the open offer or (ii) consideration for shares accepted by the acquirer, within 10 working days of the closure of the open offer.

64. What happens if regulatory approvals are delayed?

If the regulatory approvals required for completing the open offer and acquisition are delayed, the acquirer may be unable to make the payment within 10 working days of closure of open offer. In such an event, SEBI may grant extension of time for making payments, subject to the acquirer agreeing to pay interest to the shareholders of the target company for the delay at such rate as may be specified by SEBI.

If statutory approvals are required for some but not all shareholders, the acquirer can make payment to such shareholders in respect of whom no statutory approvals are required in order to complete the open offer.

65. If the payment is delayed beyond 10 working days of the closure of the tendering period (closure of open offer), will the acquirer be required to compensate the public shareholders who have participated under the offer?

Acquirer is required to complete the payment of consideration to shareholders who have accepted the offer within 10 working days from the date of closure of the open offer. If there is a delay in payment of consideration (not due to non-receipt of statutory approvals), it would be treated as a violation of the SAST Regulations, 2011 and SEBI may issue direction to such acquirer including direction to pay interest.

66. Whom do I approach if I have any grievance in respect of the open offer, delay in receipt of consideration / unaccepted shares etc.?

The shareholder of the target company should approach the manager to the open offer or the registrar to the open offer for any grievance. However, if the shareholder is not satisfied or does not receive a satisfactory response to his / her grievance, he may approach SEBI through online SEBI Complaint Redressal System (SCORES) at www.scores.gov.in.

In case, during the open offer or before the starting of the open offer, any investor has any comment/ complaint about the disclosures given by the acquirer in Public Announcement or in Detailed Public statement or in draft Letter of offer information, he can write to Corporate Finance Department, Division of Corporate Restructuring at SEBI Bhavan, Plot No.C4-A, 'G' Block, Bandra Kurla Complex, Bandra (E), Mumbai 400 051. Please note that PA/DPS, Draft Letter of offer are also available on website of SEBI.

67. Where can an investor get more information related to the SAST Regulations, 2011?

An investor can get more information related to the SAST Regulations, 2011 from the SEBI website and from the Investors website of SEBI.

68. What are the disclosures (other than the ones given in PA/ DPS/ Letter of offer for the open offer) required to be made in terms of SAST Regulations, 2011, by whom, when and to whom?

Event based Disclosures

(Please note the word "shares" for disclosure purposes include convertible securities also.)

a. Any person, who along with PACs crosses the threshold limit of 5% of shares or voting rights, has to disclose his aggregate shareholding and voting rights to the Target Company at its registered office and to every Stock Exchange where the shares of the Target Company are listed within 2 working days of acquisition as per the format specified by SEBI.

b. Any person who holds 5% or more of shares or Voting rights of the target company and who acquires or sells shares representing 2% or more of the voting rights, shall disclose details of such acquisitions/ sales to the Target company at its registered office and to every Stock Exchanges where the shares of the Target Company are listed within 2 working days of such transaction, as per the format specified by SEBI.

Continual disclosures of aggregate shareholding shall be made within 7 days of financial year ending on March 31 to the target company at its registered office and every stock exchange where the shares of the Target Company are listed by:

a. Shareholders (along with PACs, if any) holding shares or voting rights entitling them to exercise 25% or more of the voting rights in the target company.

b. Promoter (along with PACs, if any) of the target company irrespective of their percentage of holding.

Disclosures of encumbered shares

a. The promoter (along with PACs) of the target company shall disclose details of shares encumbered by them or any invocation or release of encumbrance of shares held by them to the target company at its registered office and every stock exchange where shares of the target company are listed, within 7 working days of such event.

69. How to compute trigger limits specified above for disclosures.

The word "shares" for disclosure purposes include convertible securities also. Hence for computation of trigger limits for disclosures given above, percentage w.r.t shares shall be computed taking in to account total number of equity shares and convertibles and the percentage w.r.t voting rights shall be computed after considering voting rights on equity shares and other securities (like GDRs, if such GDRs carry voting rights)

An illustration is provided below for the calculation of trigger limits for disclosures given in point (b) of the reply to query (13).

Total Shares/ voting capital of the company

- Company A has 100 equity shares, 50 partly convertible Debentures (PCDs) and 10 GDRs. 1 GDR carries 1 voting right.
- Total shares of company A= 100+50+10 =160
- Total voting capital of Company A=100+10=110

Persons B's holding of shares and voting rights

- Person B has 8 equity shares, 7 PCDs and 1 GDR.
- Person B has 8+7+1 =16 shares (shares for disclosure purpose includes convertible securities)
- Person B's holding in terms of shares= 16/160=10% of shares
- Person B's voting rights= 8+1= 9 voting rights
- Person B's holding in terms of voting rights = 9/110=8 % of voting rights

Since person B is holding more than 5% of shares or voting rights, he is required to make disclosures for any acquisition/ sale of 2% or more of shares or voting rights.

Acquisition by Person B
Scenario I

- Person B acquires 2 equity shares and 2 PCDs.
- In terms of shares, person B has acquired 4/160=2.5% of shares
- In terms of voting rights, person B has acquired 2/110= 1.8% of voting rights

Since acquisition done by person B represents 2 % or more of shares, the disclosure obligation as stated at Reply of Q-13(b) is triggered.

Scenario II

Person B acquires 20 PCDs
In terms of shares, person B has acquired 20 shares, i.e. 20/160 i.e. 12.5% shares.
In terms of voting rights, he has not acquired a single voting right i.e. 0 voting right
However, since acquisition done by person B represents 2% or more of shares (though no voting rights), the disclosure obligations as stated at (b) in reply 13 is triggered.

70. Whether promoters are required to disclose details of arrangements which place encumbrances on shares like lock-in stipulations, non-disposal undertaking, right of first refusal etc?

As per Regulation 28(3), the term "encumbrance" shall include a pledge, lien or any such transaction, by whatever name called." The promoters have to understand the nature of encumbrance and those encumbrances which entail a risk of the shares held by promoters being appropriated or sold by a third party, directly or indirectly, are required to be disclosed to the stock exchanges in terms of the Takeover Regulations, 2011.

71. If the shares of the holding company of a target company are pledged, whether the same would be covered under disclosures of "Encumbered shares" by promoters of the Target Company?

Yes, details of such pledge would be covered under disclosure of "encumbrance" as required under the Regulations

72. Whether furnishing of a Non Disposal Undertaking (NDU) by promoters to the lenders would be covered under disclosures of "Encumbered shares" by promoters of the Target Company?

Yes, all types of NDUs by promoters will be covered under the scope of disclosures of "Encumbrances" under the Regulations. These NDUs may, inter-alia, include undertaking for:

(i) not encumbering shares to another party without the prior approval of the party with whom the shares have been encumbered;
(ii) non-disposal of shares beyond a certain threshold so as to retain control;
(iii) Non-disposal of shares entailing risk of appropriation or invocation by the party with whom the shares have been encumbered or for its benefit. (Substituted for "No, mere NDU by promoters will not be covered under the scope of disclosures of Encumbrance under the Regulations. However if NDUs are given along with side-agreements which may entail the risk of shares held by the promoters being appropriated or sold by a third party, directly or indirectly, the same needs to be disclosed." On 10-12-2013)

73. What happens if the Acquirer / Target Company / Merchant Banker or the Manager to the open offer violates the provisions of the SAST Regulations, 2011?

SAST Regulations, 2011 have laid down the general obligations of acquirer, Target Company and the manager to the open offer. For failure to carry out these obligations as well as for failure / non-compliance of other provisions of these Regulations, penalties have been laid down there under. These penalties include:

- directing the divestment of shares acquired;
- directing the transfer of the shares / proceeds of a directed sale of shares to the investor protection fund;
- directing the target company / any depository not to give effect to any transfer of shares;
- directing the acquirer not to exercise any voting or other rights attached to shares acquired;
- debarring person(s) from accessing the capital market or dealing in securities;
- directing the acquirer to make an open offer at an offer price determined by SEBI in accordance with the Regulations;
- directing the acquirer not to cause, and the target company not to effect, any disposal of assets of the target company or any of its subsidiaries unless mentioned in the letter of offer;
- directing the acquirer to make an offer and pay interest on the offer price for having failed to make an offer or has delayed an open offer;
- directing the acquirer not to make an open offer or enter into a transaction that would trigger an open offer, if the acquirer has failed to make payment of the

open offer consideration;

- directing the acquirer to pay interest of for delayed payment of the open offer consideration;
- directing any person to cease and desist from exercising control acquired over any target company;
- directing divestiture of such number of shares as would result in the shareholding of an acquirer and persons acting in concert with him being limited to the maximum permissible non-public shareholding limit or below.

74. What is the procedure for a company or an intermediary in case it needs clarification or an interpretation of some provisions of SAST Regulations, 2011?

SEBI updates its FAQs section based on the queries received. You are advised to see the FAQs section. However for seeking interpretation of a particular provision or a no action letter pertaining to a particular transaction, the applicant is advised to apply under the provisions of SEBI (informal Guidance) Scheme, 2003, details of which are available on the SEBI website.

75. Are scheduled commercial banks and public financial institutions exempt from disclosure requirements under regulation 29 with regard to acquisition of shares by them on invocation of pledge?

Scheduled commercial banks and public financial institutions are not exempt from disclosure requirements under regulation 29 with regard to acquisition of shares by them on invocation of pledge. They are required to make necessary disclosures upon acquisition of shares on invocation of pledge under sub-regulation 29(1) or 29(2) as the case may be. (Please refer to SAT Order dated October 28, 2014 in the matter of SICOM Ltd vs SEBI.)

However, they are exempt from disclosure requirements under regulation 29 in connection with shares taken by way of encumbrance and shares given upon release of encumbrance under sub-regulation29(4).

76. Is proof of posting of the requisite disclosure within the time specified considered as the compliance of disclosure requirements under Takeover Regulations?

Requisite disclosures under Takeover Regulations are considered to be complied with only when they are received by the target company and the stock exchanges within the time specified thereunder. (Please refer to High Court of Calcutta Order dated March 27, 2001 in the matter of Arun Kumar bajoria vs SEBI.)

77. If the holding of any shareholder remains the same but the percentage of shareholding or voting rights of the total paid up share capital of the target company changes due to some corporate actions like buyback or preferential allotment, whether the shareholder is required to make disclosure of the change in shareholding disclosure under regulation 29(2) of Takeover Regulations, 2011?

No. Any change in shareholding or voting rights of a shareholders of a company pursuant to corporate actions like buyback or preferential allotment would not require a disclosure under regulation 29(2) of Takeover Regulations, 2011.

78. Can the letter of offer be dispatched through electronic means?

Letter of offer can be dispatched through electronic means in accordance with the provisions in the Companies Act, 2013. However, on receipt of a request from any shareholder to receive a copy of the letter of offer in physical format, the same shall be provided. Besides this, for all those shareholders who do not have their email IDs registered with the company, the letter of offer shall be sent physically. This shall be disclosed in the letter of offer.

79. How is the 'volume-weighted average market price' of shares for a period of sixty trading days calculated under the Takeover Regulations?

Regulation 2(1)(zb) of Takeover Regulations, 2011 defines volume-weighted average market price (VWAP) to mean the product of the number of equity shares traded on a stock exchange and the price of each equity share divided by the total number of equity shares traded on the stock exchange. Accordingly, VWAP for a period of 60 trading days is calculated by aggregating daily turnover in the scrip over the period of 60 trading days and dividing the same by the total number of shares traded during the said period.

For illustration,

$$VWAP_{60} = \frac{TO_1+TO_2+ \ldots\ldots +TO_{60}}{Q_1+Q_2+\ldots\ldots + Q_{60}}$$

[Where, $VWAP_{60}$ = VWAP for a period of 60 trading days

TO_n = Total turnover in the scrip on 'n^{th}' trading day

Q_n = Number of shares of the scrip traded on 'n^{th}' trading day]

Module III: Cross Border M&A activities

Cross Border Mergers & Acquisitions

In globalization period, Cross-border mergers and acquisitions (M&As) have increased radically over the last two decades. Horn and Persson (2001) and Norback and Persson (2004) presented theoretical models where foreign companies may acquire domestic acquisition targets, with the acquisition price being determined endogenously in a bargaining process. In these models, they find that high trade costs do not necessarily induce foreign M&As, contrary to the tariff jumping argument.

Cross-border mergers and acquisitions (M&As) is in increment trend in contemporary business environment. It is often specified that cross-border capital reallocation is partly the result of financial liberalization policies, government policies and regional agreements. Conventionally, developed countries, and in particular the developed countries of the European Union (EU15) and the United States, have been the major acquirer and target countries of M&As.

During 2003-2005 period, developed countries accounted for 85% of the USD 465 billion cross-border M&As, 47% and 23% of which respectively pertains to EU15 and US firms either as acquirer or as target countries (UNCTAD (2006).

Cross border Mergers and Acquisitions deals between foreign corporations and domestic firms in the target country. The trend of increasing cross border M&A has become faster with the globalization of the world economy. Definitely, the 1990s were important period for cross border M&A with a nearly 200 percent jump in the volume of such deals in the Asia Pacific region. This region was favoured for cross border M&A as most nations in this region were opening up their economies and liberalizing their policies, which provided the much, needed boost to such deals.

It has been observed in current scenario that Latin America and Africa are attracting more cross border M&A. This is due to a combination of political congestion in countries like India that are unable to decide on whether the country needs more foreign investment, the saturation of China, and the rapid emergence of Africa as an investment destination. Additionally, Latin America is being favoured mainly due to the rapid growth rates of the economies of the region.

In spite of increased importance of cross-border M&As, which constitute by far the largest share of foreign direct investment, the determinants underlying such activities remain unclear. Di Giovanni (2005) and Head and Ries (2007) found cultural and geographical proximity to be important determinants of aggregate Mas. Berger at al. (2004) who using Tobit look at determinants of cross-border transaction values in the financial sector; while Goerg et al (2006) and Focarelli and Pozzolo (2008) emphasize the number of cross-border deals using the negative binomial regression model, respectively for M&As in manufacturing sectors and those in banking and insurance.

Motivation for cross-border mergers and acquisitions is to build shareholder value. The drivers of M&A activity are both macro in scope the global competitive environment and micro in scope the variety of industry and firm-level forces and actions driving individual firm value. The main forces of change in the global competitive environment, technological change, regulatory change, and capital market change and create new business opportunities for MNEs, which they pursue aggressively.

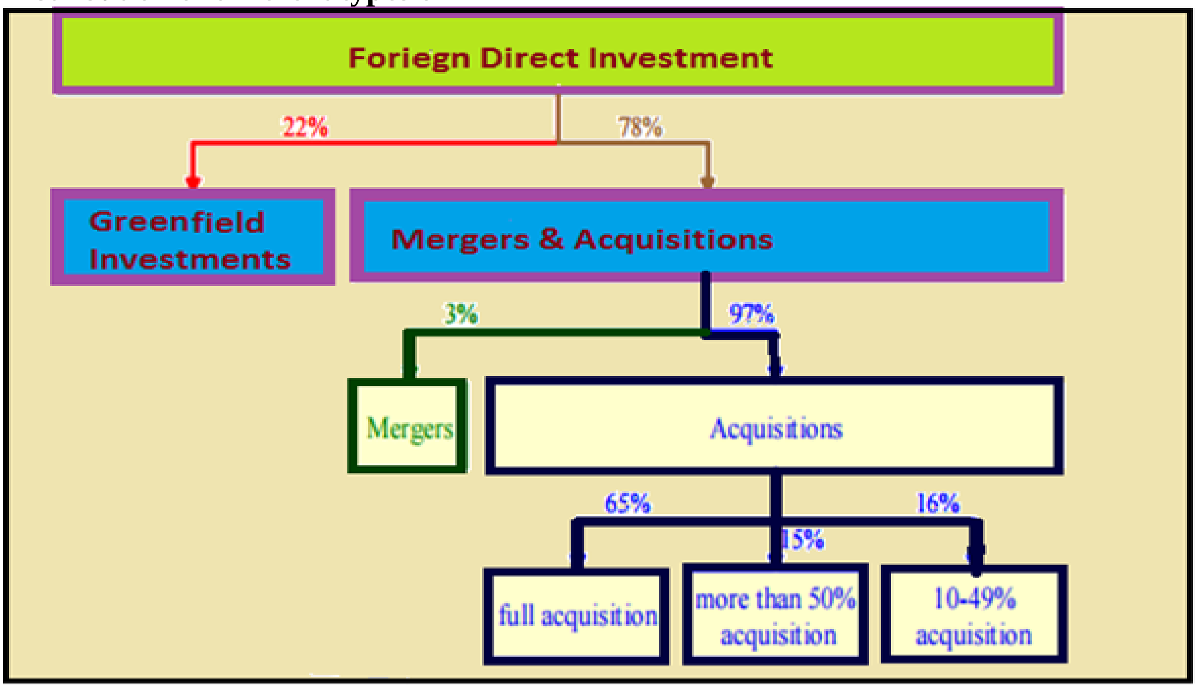
Multinational enterprises undertake cross-border mergers and acquisitions for various reasons. The drivers are strategic responses by Multinational enterprises to protect and augment their global competitiveness by

1. Gaining access to strategic proprietary assets.
2. Gaining market power and dominance.
3. Achieving synergies in local/global operations and across industries.
4. Becoming larger, and then reaping the benefits of size in competition and negotiation.
5. Diversifying and spreading their risks wider.
6. Exploiting financial opportunities they may possess and others desire.

Cross-border M&A is characteristically considered to be a subsection of foreign direct investment ranging from about 50% to 90% depending on the source that is consulted. The remainder of FDI is realised through Greenfield investment. Therefore, a majority of FDI tends to occur through cross-border M&A. While experts think the cross-border M&A as useful component of FDI, the relationship between cross-border M&A and FDI is complicated as is made clear in UNCTAD's World Invest Report for 2000, which is specifically dedicated to the issue of cross-border mergers and acquisitions.

FDI, in contrast to cross-border M&A, denotes to transactions between parents and affiliates. Cross-border M&A includes also investments that are financed via domestic and international capital markets. It is not always possible to trace the country from which these funds originate. Moreover, FDI refers to net investments whereas M&A refer to gross transactions (acquisitions and divestments). Due to those differences, it is therefore possible that cross-border M&A exceeds the documented value of FDI.

Distribution of different types of FDI



Basic Characteristics of Cross-border M&As:
Thomson's Global Mergers and Acquisitions database offers the best and extensive data source for M&As to date. Cross border merger and acquisitions are of two types Inward and Outward. Inward cross border M&A's involve an inward capital movement due to the sale of a domestic firm to a foreign investor. Conversely outward cross border M&A's involves outward capital movement due to purchase of a foreign firm. Inward and outward M&A's are closely linked as on a whole M&A transactions comprise of both sales and purchase.

Factors to be considered in Cross Border Mergers and Acquisitions:
It is established in business reports that cross border M&A's actualize only when there are incentives to do so. Both the foreign company and the domestic partner must gain from the deal as otherwise; eventually the deal would turn sour. Many domestic firms in emerging markets overstate their capabilities in order to attract M&A, the foreign firms have to do their due diligence when considering an M&A deal with a domestic firm.

Due to these reasons, many foreign firms get assistance of management consultancies and investment banks before they venture into an M&A deal.

Apart from this, the foreign firms also consider the risk factors associated with cross border M&A that is a combination of political risk, economic risk, social risk, and general risk associated with black swan events. The foreign firms evaluate potential M&A partners and countries by forming a risk matrix composed of all these elements and depending upon whether the score is appropriate or not, they decide on the M&A deal. Cross border M&A also needs regulatory approvals as well as political support because in the absence of such expediting factors, the deals cannot go through.

Numerous factors which motivate firms for cross border M&A's include

1. Globalization of financial markets
2. Market pressures and falling demand due to international competition
3. Seek new market opportunities since the technology is fast evolving
4. Geographical diversification which would result in exploring the assets in other countries
5. Increase companies efficiency in producing the goods and services
6. Fulfilment of the objective to grow profitably
7. Increase the scale of production
8. Technology share and innovation which reduces costs

Effects of Cross Border Merger and Acquisitions
Normally, it is apparent that cross border merger and acquisitions are a reformation of industrial assets and production structures on a worldwide basis. It empowers the global transfer of technology, capital, goods and services and integrates for universal networking. Cross border M&A's leads to economies of scale and scope which helps in gaining efficiency.

Apart from this, it also benefits the economy such as increased productivity of the host country, increase in economic growth and development particularly if the policies used by the government are favourable.

Capital build-up:
Cross border merger and acquisitions support in capital accumulation on a long term basis. In order to expand their businesses it not only undertakes investment in plants, buildings and equipment's but also in the incorporeal assets such as the technical know-how, skills rather than just the physical part of the capital.

Employment creation:
It is observed that the M&A's that are undertaken to drive restructuring may lead to downscaling but would lead to employment gains in the long term. The downsizing is sometimes essential for the continued existence of operations. When in the long run the businesses expands and becomes successful, it would create new employment opportunities.

Technology handover:
When firms across countries join together, it sustains positive effects of transfer of technology, sharing of best management skills and practices and investment in intangible assets of the host country. This results in innovations and has an influence on the operations of the company.

Cross Border Merger and Acquisitions - Issues and Challenges
It is analysed that cross border merger and acquisitions are quite similar to domestic M&A's. But because the former are huge and international in nature they pose certain unique challenges in terms of different economic, legal and cultural structures.

There could be huge differences in terms of customer's choices, business practices, and the culture which could pose as a huge threat for companies to fulfil their strategic objectives. There are many issues and challenges related to cross border merger and acquisitions.

1. Political concerns:
Political situation has major role in cross border merger and acquisitions, particularly for industries which are politically sensitive such as defence, security etc. It is also important to concerns of the parties like the governmental agencies (federal, state and local), employees, suppliers and all other interested should be addressed subsequent to the plan of the merger is known to public.

In fact in certain cases there could be a requirement of prior notice and discussion with the labour unions and other concerned parties. It is important to identify and evaluate present or probable political consequences to avoid any probability of political risk arising.

2. Cultural challenges:
Cultural factors exert more threat to the success of cross border merger and acquisitions. From past records, it can be established that huge mergers that have failed because of the cultural issues they have had. When there are cross border transactions issues arise because of the geographic scope of the deal. Several factors such as differing cultural backgrounds, language necessities and dissimilar business practices have led to fail mergers in spite of being in the age where we can instantly communicate.

Research suggests that intercultural disagreement is one of the major indicator of failure in cross-border merger and acquisition. Hence irrespective of what the objective behind the alliance is businesses should be well aware of the of the intercultural endangerment and prospects that come hand in hand with the amalgamation process and prepare their workforce to manage these issues.

In order to deal with these challenges businesses need to invest good amount of time and effort to be well aware of the local culture to gel with the employees and other concerned parties. It is better to over communicate and conforming things for successful merger.

3. Legal considerations:

Firms interested to merge cannot ignore the challenge of various legal and regulatory issues. Various laws in relation to security, corporate and competition law are bound to diverge from each other. Hence before considering the deal, it is important to review the employment regulations, antitrust statute and other contractual requirements to be dealt with. These laws are very much part of both while the deal is under process and also after the deal has been closed. While undergoing the process of reviewing these concerns, it could indicate that the potential merger or acquisition would be totally incompatible and hence it is recommended to not go ahead with the deal.

4. Tax and accounting considerations:
Tax issues are critical particularly when it comes to structuring the transactions. The proportion of debt and equity in the transaction involved would influence the outlay of tax; hence a clear understanding of the same becomes important. Another factor to decide whether to structure an asset or a stock purchase is the issue of transfer taxes. It is very important to lessen the tax risks.

Countries also follow different accounting policies though the acceptance of IFRS has reduced this to an extent and many countries have yet to implement it. If the parties in the merger are well aware about the financial and accounting terms in the deal, it would aid in minimizing the misperception.

5. Due diligence:
Due diligence is significant element of the M&A process. Apart from the legal, political and regulatory issues, there are also infrastructure, currency and other local risks which need thorough appraisal. Due diligence can affect the terms and conditions under which the M&A transaction would take place, influence the deal structure, and affect the price of the deal. It supports in revealing the danger area and gives a comprehensive view of the proposed dealings. It has been recognized that Cross border merger and acquisition has numerous advantages but also there is high risk of failure. Researches demonstrate that the failure rate is as high as 50% (Valant, 2008). The main reason for that are cultural differences (Badrtalei and Bates, 2007). One of the major merger which has failed is the merger between Daimler and Chrysler.

To summarize, a cross-border M&A is elaborated as an activity in which an enterprise from one country buys the whole asset or controlling percentage of an enterprise in another country. Cross border merger and acquisitions is highly advantageous to companies and also increase its share price but as we saw there are a lot of factors which need to be taken into consideration to avoid any anomalies. It is documented that Cross-border M&A has become one of the leading approaches for firms to gain access to global markets.

Though there has been little progress in the research literature to explore the role of culture in the success of these ventures. Poor culture-fit has often been cited as one reason why M&A has not produced the outcomes organizations hoped for (Cartwright & Schoenberg, 2006). Cross-border M&A has the added challenges of having to deal with both national and organizational culture differences. It is imperative for the business structures of both the countries involved in M&A transactions and learn from cases like that of Daimler-Chrysler.

Most critical factors which separate the successful M&A transactions from the others, who fail, are thorough and planned preparation and commitment of time and other resources.

Legal aspects of Cross Boarder M&A activities

Merger is a kind of arrangement under Section 230 of the **Companies Act 2013**, which takes place through the consolidation of shares of different classes and then its division into separate classes. Therefore, Cross Border Merger would fall into such category of Arrangement.

The concept of Merger is specifically defined in explanation (i) to Section 232 of the Act, which provides for two kinds of mergers - first, ‘merger by absorption’ wherein one existing company absorbs or takes over the another existing company or more than one existing company and second, ‘merger by formation of a new company’ wherein two or more existing companies come together, consolidate their assets and convert themselves into single new entity.

What Is Cross Border Merger?

In very simple words, it can be defined as a combination of businesses of two or more companies incorporated in two or more countries. Companies of different jurisdiction basically go through this process in order to enhance their growth and elevate their standard to compete in International market.

Section 234 of the Companies Act 2013 defines it as a merger between company or companies registered under the Act or previous Companies Act and the company incorporated outside India in the notified foreign jurisdictions.

The Companies Act, 1956

The Act respecting the cross border merger (CBM) was very limited, since it only recognized the situation where resultant company i.e. transferee company would be an Indian entity and not vice versa and so the Act in this respect, with the growing needs of Indian economy had become outdated since it was not in line with the impliedly encouraged principles of globalization.

The Companies Act, 2013

Now only with the enactment of the Companies Act 2013, both **Inbound Merger where resultant company is an Indian company** and **Outbound Merger where resultant company is foreign company** were facilitated, since the Act provides that “subject to the provisions of any other law for the time being in force, a foreign company may with the prior approval of Reserve Bank of India, merge into a company registered under this Act or Vice Versa"

The Procedure and Compliance

The Companies Act, 2013:
Application under Section 230 of the Act, has to be made to the Tribunal by either of the party to CBM and on such application, Tribunal may call the meeting of members or creditors or both, for the purpose of obtaining approval of the proposed scheme through voting by such members or creditors or both and entertaining the objections which may be raised by them.

Along with the application, certain necessary information relating to the company and its business, especially 'certificate by Company's auditor as to accounting treatment of the Company' has to be filed before the Tribunal, so that, it can ascertain the colorable nature of proposed scheme, if so exists.

The notice for such meeting along with the creditors and members, if required shall also be sent to the Central Government of India, Income Tax Authority, Reserve Bank of India (RBI), Security and Exchange Board of India (SEBI), Competition Commission of India (CCI), the Registrar, respective Stock Exchanges, the Official Liquidator. Each of them on receiving such notice shall be allowed to raise objections to such proposed scheme within thirty days.

The merger would become binding, if three-fourth of the creditors in their debt value or members in their shares value, as the case may be, vote in favor of such CBM or if the scheme is otherwise approved by the Tribunal. The requirement of 'meeting of creditors' would not be there if the creditors holding at least 90% value of total outstanding debt, approved the scheme of CBM by way of an affidavit.

The Competition Act, 2002:
Regardless of any other procedure under any other law, the Competition Act under Section 6 requires merging companies, if such merger meets the threshold limit, qualifying to be a combination under Section 5, to give notice to the CCI, within thirty days of approval of proposed scheme of merger by the Board of directors of the companies involved or execution of any agreement or other document in furtherance of acquisition proceedings.

This law further provides the waiting period of two hundred and ten days from the day of giving notice to CCI, for the purpose of holding an investigation under Section 29 and 30 as to check the existence of any possibility of its appreciable adverse effect on competition.

If the CCI under Section 31 of the Act, is satisfied as to the answer in negative for the question of appreciable adverse effect then it shall approve the scheme, but where it concludes after thorough analysis that the merger is likely to have such effect then such scheme has to be disapproved by the CCI except where there is a scope for modification in such scheme as to make it fit for approval.

Inbound Merger
The functional aspects for inbound merger have been primarily provided in Regulation 4 of Foreign Exchange Management (Cross Border Merger) Regulations, 2018.

Transfer or Issue of securities - It is to be understood that when the foreign company merges into an Indian company, the resultant Indian company needs to pay the consideration to the other party, which could be done by any of the following methods-

a. Paying off the ascertained value of the total assets of the other party, either in cash or in depository receipt or partly in cash and partly in depository receipts, or
b. By issuing its securities to the shareholders of the other party, or
c. Through both the modes.

When it comes to the **issuance of securities**, the resultant Indian company is to be guided by the 'FDI Regulations 2017' in respect of **pricing guidelines** , **entry routes, sectoral caps, attendant conditions** and reporting requirements for foreign investment. While if the merging foreign company is Joint Venture/wholly owned subsidiary of an Indian company then the resultant Indian Company has to comply with the **ODI Regulations 2004**

Holding assets outside India - Apart from issuing securities, the transferee Indian company may on account of CBM also hold or acquire any asset outside India, if permitted under the Foreign Exchange Management Act, 1999, its rules, regulations and may further perform any transaction in respect of the same. And if any such asset is not permitted to be acquired, it shall be sold off within two years from the approval of the CBM scheme by the Tribunal and the sale proceeds to be repatriated to India through Banking Channels.

Office of the transferor foreign company outside India shall be deemed to be a branch office of transferee Indian company in the process of execution of CBM scheme, Hence any transaction may be performed through such office, so permitted to it under Foreign Exchange Management (Foreign Currency Account by a person resident in India) Regulations, 2015

Moreover Overseas borrowings of such transferor company becomes the liabilities of resultant company and therefore it needs to confirm to the External Commercial Borrowing norms or Trade Credit norms or other foreign borrowing norms, as laid down under Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000, within two years of approval of the scheme.

Outbound Merger-

Regulation 5 of the Foreign Exchange Management (Cross Border Merger) Regulations, 2018, facilitates the process of CBM when resultant company is a foreign party and provides that the said process shall be guided by ODI Regulations 2004 in respect of holding the securities of transferee foreign company by existing Indian shareholders of transferor company, if securities are being issued to them as consideration.

Borrowings of transferor Indian company shall be repaid by the resultant company in accordance with the terms of the scheme so approved by the Tribunal, however where such repayments are to be made to an Indian lender in rupees then the resultant company should obtain no objection certificate from such lender regarding conformity with the FEMA, rules and regulations made thereunder.

It further provides that office of transferor Indian company may be deemed to be a branch office of transferee foreign company and therefore such transferee company would be able to transact business from such deemed branch office as permitted under Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016.

The resultant foreign company may also hold or acquire assets in India on account of CBM, if permitted under FEMA and may further perform transactions in respect of the same. And if holding of any asset is not permitted then such asset shall be sold off within two years from the date of the approval of the CBM scheme.

It is a legal duty of the Indian party holding securities in resultant company to receive share certificate as an evidence of investment and repatriate to India all the receivables on such shares held by it and report to the RBI every year within specified time.

Transferee foreign company should further ensure that valuation of the assets or shares are being done by the valuers of recognized professional body in accordance with the internationally accepted principles on accounting and valuation. Law is silent on this aspect in case of an inbound merger.

Notified foreign jurisdiction for outbound merger is as follows-

(i) Whose securities market regulator is a signatory to International Organization of Securities Commission's Multilateral Memorandum of Understanding or a signatory to bilateral Memorandum of Understanding with SEBI, or

(ii) Whose central bank is a member of Bank for International Settlements (BIS), and

(iii) A jurisdiction, which is not identified in the 'public statement of Financial Action Task Force (FATF) as:

(a) A jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or

(b) A jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

This jurisdiction has been specified to create a sense of accountability, assure the credibility on part of such foreign acquirer company and avoid any risk towards which Indian party could be exposed if foreign party would not belong to such specified jurisdiction,. However, 'such foreign company need not have any place of business in India' in order to be eligible for absorbing an Indian Company.

Law again does not specify any such jurisdiction for foreign company, in case of an inbound merger.

Rationale-

There can be number of reasons behind the transaction of such merger which could definitely vary from company to company according to their goals, however from the past experiences of such transaction, 'following common rationales' may be safely drawn out-

a. Growth - Achieving growth through merger is less time consuming method than that by internal changes and diversification.

b. Synergy- 'Working Together' always fetches better results and therefore, when two companies combine their assets and business operation, they are most likely to achieve their set goals more effectively.

c. Profitability- After merger, resources of the company are likely to get optimized through the increased volume of production, which would ultimately lead to the reduction in production cost and increase in profit.

d. Market Power- Acquisition of a company who has a good market base surely facilitates the goal of an acquirer company to attain dominance in such market.

e. Access to Resources- An acquirer company may get the control over raw materials, innovation, technology and other local resources in the jurisdiction of acquiring company.

f. Global Market- The very primary purpose of any company for CBM would be to get elevated at international market and to compete with international firms.

As stated that purpose of such CBM may not always be those as commonly understood and this can be best deduced from the acquisition of Zain Group (a Kuwait based telecommunication company) by Bharti Airtel an Indian telecommunication company, whose 'financial performance

Legal Challenges and Loopholes

The very first challenge is quite apparent that, there might be various conflicts in the compliance laws of concerned jurisdictions. Not every country confers even statutory recognition on cross border merger.

Section 47(vi) and (vii) of the Income Tax Act 1995 exempts inbound merger from taxation, while law is silent on the issue for outbound merger and therefore the transaction of such outbound merger would be taxed till corresponding amendments are also brought to the said Act in consonance with the Companies Act 2013.

The process of merger is not that easy which it appears merely from Foreign Exchange Management rules and regulations, rather number of other regulatory bodies are also involved in the transaction, such as Security exchange authorities, Competition authorities of concerned jurisdictions. Whenever such transaction is proposed to be performed then cooperation between such authorities of two or more jurisdictions is highly recommended.

A CBM in order to be governed by the Competition Act 2002 must meet the threshold limit given in Section 5 of the Act. Further Section 6(1) of the said Act provides that a combination (includes cross border merger) which if, even has a tendency to cause appreciable adverse effect on competition shall be void, however there are no clear and cut formula to figure out such possibility. And therefore any such merger which is not qualifying under Section 5 as a combination, even if causing appreciable adverse effect on competition in India, would not be governed by the Act.

The companies Act 2013 was a step towards smooth acceptance of CBM, which is evident from the inclusion of outbound merger, but it still needs to deal with the CBM more specifically and separately from the domestic merger and amalgamations. And same goes with the Competition law as well, since there is no bifurcation of procedure between domestic and cross border merger.

Summary

Corporate sector in India is surely moving towards the stage where globalization and its principles are intended to be accepted by the state through favorable legislations but, due to existence of multiple technical legislations governing the concerned subject, it is almost impossible to attain the most desirable stage with one attempt.

As discussed above, the very first step was the enactment of the Companies Act 2013 itself, the scope of which was further broadened with the insertion of Rule 25A to the Companies (compromise, arrangement and amalgamation rules) 2017 in respect of outbound merger.

In the same line, another major development was the issuance of regulations called 'Foreign Exchange Management (Cross Border Merger) Regulations, 2018'.

However, in order to compete at global platform effectively and to fill the loopholes, corresponding amendments are required to be brought in the Competition and Income Tax legislation.

Cross-border Mergers – Analysis of FEMA provisions

On 13th April 2017, the Ministry of Corporate Affairs (MCA) notified Section 234 of the Companies Act, 2013 and inserted a new Rule 25A (merger or amalgamation of a Foreign Company with Indian company and vice-versa) in the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 (Compromises Rules), paving way for merger and amalgamation of a Foreign Company with an Indian company and vice-versa. Since Rule 25A required prior approval of the Reserve Bank of India (RBI) for cross-border merger, without corresponding procedural aspects in place, cross-border merger could not take-off.

Now, with the RBI notifying the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 (FEMA Regulations/Regulations) for mergers amalgamation and arrangement between Indian and foreign companies on 20th March 2018, this gap has been bridged.

Crucial definitions

The FEMA Regulations cover both inbound and outbound investments. The term "Inbound Merger" means a Cross Border Merger where the Resultant Company is an Indian company whereas "Outbound Merger" means a Cross Border Merger where the

Resultant Company is a Foreign Company. The “Resultant Company” means an Indian company or a Foreign Company which takes over the assets and liabilities of the companies involved in the cross-border merger.

FEMA Regulations define “Cross Border Merger” as any merger, amalgamation or arrangement between an Indian company and a Foreign Company in accordance with the Compromises Rules. The term “Foreign Company” has been defined as any company or body corporate incorporated outside India in a jurisdiction specified in Annexure B to Compromises Rules whether having a place of business in India or not.

Cross-border merger: Procedural aspects

Inbound Mergers
When the Resultant Company is an Indian Company, the following procedure becomes applicable:

i. Issue/Transfer of securities:
The issue or transfer of any security and/or a foreign security, to a person resident outside India should be made in accordance with the pricing guidelines, entry routes, sectoral caps, attendant conditions and reporting requirements for foreign investment as laid down in Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017 (TISPRO). However, this is subject to the following conditions:

1. where the Foreign Company is a joint venture (JV) or a wholly owned subsidiary (WOS) of the Indian company, it shall comply with the conditions prescribed for transfer of shares of such JV/ WOS by the Indian party as laid down in Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004 (TIFS);

2. where the Inbound Merger of the JV/WOS result into acquisition of the Step-down subsidiary of JV/ WOS of the Indian party by the Resultant Company, then such acquisition should be in compliance with Regulation 6 and 7 of TIFS which provide for permission for direct investment in certain cases and investment by Indian party engaged in financial services sector respectively.

ii. Borrowings :
Any borrowing of the Foreign Company from overseas sources that becomes the borrowing of the Resultant Company shall conform within a period of two years, to Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000 or Foreign Exchange Management (Guarantee) Regulations, 2000, as applicable.

Procedure of Cross Border M&A activities
Cross-border mergers and acquisitions have rapidly increased reshaping the industrial structure at the international level. A cross-border merger means any merger, amalgamation or arrangement between an Indian company and a Foreign Company in accordance with the Companies Act, 2013 and the Companies (Compromises, Arrangements, and Amalgamations) Rules 2016.

The Ministry of Corporate Affairs notified Section 234 of the Companies Act, 2013 thereby enabling cross-border mergers with effect from 13 April 2017. Thus, it was a matter of time that the Reserve Bank of India notified the regulations in order to operationalize the cross-border merger.

Regulatory Framework

In India, Cross border is majorly regulated under (i) the Companies Act 2013; (ii) SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011; (iii) Competition Act 2002; (iv) Insolvency and Bankruptcy Code 2016; (v) Income Tax Act 1961; (vi) The Department of Industrial Policy and Promotion (DIPP); (vii) Transfer of Property Act 1882; (viii) Indian Stamp Act 1899 (ix) Foreign Exchange Management Act 1999 (FEMA) and other allied laws as may applicable based on the merger structure.

The two most relevant regulations under FEMA from a merger & amalgamation perspective are Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 (the **FDI Regulations**) and Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 (the **ODI Regulations**). In addition to this, the Reserve Bank of India (the **RBI**) has notified Foreign Exchange Management (Cross-Border Merger) Regulations, 2018 (the **Cross-Border Regulation**) under the Foreign Exchange Management Act, 1999 to include enabling provisions for mergers, demergers, amalgamations and arrangements between Indian companies and foreign companies covering Inbound and Outbound Investments.

This is a significant move as there will be a massive surge in the flow of Foreign Direct Investment with the enactment of new laws and tweaking of existing policies.

Inbound & Outbound Merger

Cross-Border Merger could be either Inbound merger or Out-bound Merger. Inbound Merger means a cross-border merger, where the resultant company is an Indian company. An outbound merger means a cross-border merger where the resultant company is a foreign company. A resultant company means an Indian company or a foreign company which takes over the assets and liabilities of the companies involved in the cross-border merger.

Key provisions of the Cross-Border Regulation in case of Inbound Mergers

<u>Issuance of Securities</u>

As a consideration, the Indian company would issue or transfer of securities to the shareholders of transferor entity which may include both persons resident in India and person resident outside India. In case of a person resident outside India, the issuance of securities shall be in accordance with the pricing guidelines, sectoral caps and other applicable guidelines as prescribed under the Cross-Border Regulation.

However, if the foreign company is a JV/WOS then it shall comply with the conditions prescribed as specified in Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004. Further, if the inbound merger of the JV/WOS results into an acquisition of the one or more step-down subsidiary of JV/ WOS of the Indian party by the Resultant Indian company, then such acquisition should be in compliance with Regulation 6 and 7 of the ODI Regulations.

Vesting of Assets & Liabilities

- Any borrowings or guarantees of the transferor company shall become the borrowings or guarantees of the resultant company. A timeline of two years has been provided to conform with the external commercial borrowings compliance. The end use restrictions would not apply in such cases.
- Any asset acquired by the resultant company can be transferred in any manner as permissible under the Act or regulations. Where such asset is not permitted to be acquired, the resultant company shall sell the same within two years from the date of sanction of order by the National Company Law Tribunal (the **NCLT**) and the sale proceeds shall be repatriated to India immediately through banking channels. Where any liability outside India is not permitted to be held by the resultant company, the same may be extinguished from the sale proceeds of such overseas assets within the period of two years.
- The resultant company is permitted to open a bank account in the foreign country's jurisdiction for overseeing transactions related to the merger for a maximum period of two years from the date of sanction of scheme by the NCLT.

Valuation

The valuation shall be done as per Rule 25A of the Companies (Compromises, Arrangements, and Amalgamations) Rules 2016 i.e., by Registered Valuers who are members of recognized professional bodies in the prescribed jurisdictions of the transferee company and such valuation is in accordance with internationally accepted principles on accounting and valuation.

Key provisions of the Cross-Border Regulation in case of Outbound Mergers

Issuance of Securities

(a) As a consideration, the Foreign Company would issue securities to the shareholders of Indian entity which may include both persons resident in India and person resident outside India. In case if shares are being acquired by a person resident in India, then such acquisition shall be subject to the ODI Regulations as prescribed by the RBI.

Vesting of Assets & Liabilities

- The guarantees or borrowings of the resultant company shall be repaid as per the scheme sanctioned by the NCLT. Further, they should not acquire any liability not in conformity with the Act or regulations as prescribed. A no objection certificate to this effect should be obtained from the lenders in India of the Indian company.
- Any asset acquired can be transferred in any manner as permissible under the Act or the regulations thereunder. In cases where it cannot be held or acquired by the resultant company, it shall be sold within two years from the date of sanction of the scheme by the NCLT and the sale proceeds shall be repatriated outside India immediately through banking channels. Repayment of Indian liabilities from sale proceeds of such assets or securities within the period of two years shall be permissible.

Opening a Bank Account

The resultant company is permitted to open a Special Non-Resident Rupee Account (SNRR Account) for the purpose of for overseeing transactions related to the merger for a maximum period of two years from the date of sanction of a scheme by the NCLT.

Valuation
The valuation shall be done as per Rule 25A of the Companies (Compromises, Arrangements, and Amalgamations) Rules 2016 i.e., by registered valuers who are members of recognized professional bodies in the prescribed jurisdictions of the transferee company and such valuation is in accordance with internationally accepted principles on accounting and valuation.

Other Compliances
The resultant company and/or the companies involved in the cross-border merger shall be required to furnish reports as may be prescribed by the RBI, in consultation with the Government of India, from time to time.It is pertinent to note that at the time of sanctioning the merger of a foreign transferor body corporate with an Indian transferee company, the NCLT shall consider the validity of the merger as per the laws of the country in which the foreign body corporate has been incorporated, and any transaction on account of a cross-border merger undertaken in accordance with Cross-Border Merger regulations will be deemed to have prior approval of the RBI.

A range of complex issues must be navigated in an effort to successfully complete cross-border mergers. Each cross-border merger is different and implementation of these issues will greatly depend on the facts, dynamics, scale and geographic scope of both companies. The Cross-Border Regulations being fairly new, a lot of practical issues are yet to be identified and shall be addressed as and when encountered in the due course of time.

Financing Domestic & Cross Boarder Acquisitions
Over the past two decades, liberalization has transformed India from an inward looking state-based economy to a globalised market-based economy which is now considered to be one of the most attractive destinations for investment. While restrictions on debt financing of acquisitions still exist, India has seen an increase in the use of innovative financial instruments to fund such acquisitions, some of which are attributable to exposure to private equity players.

2015 saw Indian private equity and venture capital activity at an all-time peak, contributing more than 60% (across around 1,000 investments) of overall deal volume and 35% (US$16 billion) of overall deal values (source: Grant Thornton's *11th Annual Dealtracker*).

The technology sector continued to dominate the deal volume with 33 deals (with a total disclosed value of US$557 million) during the first quarter of 2016. The infrastructure sector followed with 32 deals valued at US$746 million. Real estate companies, telecom companies, pharmaceutical companies, e-commerce companies and large scale manufacturing companies are other typical targets in India.

Acquisitions are typically classified into two categories:

- Investments into India, which includes domestic investments as well as foreign direct investments.
- Investments from India abroad, which includes overseas direct investment.

In addition to private equity players, other significant players in the acquisition finance market include:

- Foreign venture capital investors.
- Foreign portfolio investors (formally foreign institutional investors).
- Non-bank financial companies (NBFCs) (which are funded by Indian entities and private equity investors).
- Entities such as debt funds and mutual funds who subscribe to non-convertible debentures issued by an acquiring company incorporated in India.

While debt remains a large source of funding acquisition transactions, owing to various restrictions imposed by the Reserve Bank of India (RBI) (that is, the central bank of India) on banks, purchasers prefer equity or mezzanine debt financing. However, in the recent years the foreign portfolio investment route for subscribing to corporate bonds has been a large source of acquisition financing.

Methods of acquisition

The purchase and sale of a business including the purchase of a division or a subsidiary can be structured as a share purchase, merger or as asset purchase.

Asset acquisition

The decision to structure a transaction as an asset purchase primarily revolves around commercial and tax considerations. One of the most important advantages of an asset purchase is that the buyer can select (cherry pick) the assets and not assume the liabilities associated with the business that is being acquired.

However, the issues that should be borne in mind in an asset purchase are:

- The necessity for multiple ancillary documents.
- Stamp duty implications (which are higher in case of asset transfers that would be construed as a conveyance).
- Direct and indirect tax implications.
- Whether the asset being acquired include immovable property.
- Whether the purchaser is resident/non-resident.

In addition to the above, individual approvals from creditors, regulatory authorities and third parties are also required for the transfer of the undertaking, licences and other business-related agreements, which can be a time consuming process.

A company can also "hive-off" its assets to a separate new company under its control, which allows the buyer to acquire the new company (minus the aspects that are not for sale or are not wanted) by means of a share sale.

Share acquisition

Shares (or instruments convertible into shares) of an existing company can be acquired by way of a:

- Preferential allotment of newly issued shares made by the company.
- Secondary sale of existing shares from a shareholder of the company.

In both cases above, the acquisition must comply with the provisions of the Companies Act 2013 (Companies Act).

If a company is listed on a stock exchange, the existing (listed) shares can also be acquired through an open market purchase on the stock exchange in certain cases.

Further, the allotment of shares to a non-resident entity will be subject to the pricing guidelines as required by the Reserve Bank of India (RBI) (among other things). The RBI has also allowed optionality clauses in equity instruments being issued to non-residents under the foreign direct investment scheme, subject to certain conditions (such as minimum lock-in period and so on).

Merger

Mergers and other forms of restructuring in India are court-driven, and must be carried out in accordance with the Companies Act 1956 (Old Companies Act). The motive behind a merger can be (among other things):

- Better economies of scale.
- Corporate synergy.
- Consolidation of business.

The circumstances and reasons for every merger are different and these circumstances affect the way the deal is dealt, approached, managed and executed.

Acquisition financing is typically not used in cases of mergers, as mergers usually occur on an all-shares basis.

Structure and procedure

Procedure

The governing law of acquisition financing documents depend on the location of parties involved in the transaction. If both the purchaser and the seller are located in India, the documents will be governed by Indian law. However, if one party is located offshore, the parties can mutually agree to a jurisdiction offshore or can resort to arbitration in London, Singapore or The Hague. Typically, non-convertible debenture documentation is governed by Indian law.

For an acquisition finance transaction involving a non-resident party, the most important legal rules are the:

- Foreign Exchange Management Act 1999 and its related rules and regulations.
- Foreign investment policy of the Government of India, notified through various press notes.

For listed companies, the applicable laws are the:

- Securities and Exchange Board of India Act 1992 (SEBI Act) and its related rules, regulations and guidelines.
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011 (Takeover Code).
- SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 (ICDR Regulations).

- SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 (LODR Regulations).
- Indian Contract Act 1872.

For acquisitions financed through debt, the applicable laws include the:

- Transfer of Property Act 1882.
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Act 2002 (SARFAESI Act).
- Recovery of Debts due to Banks and Financial Institutions Act 1993.
- Old Companies Act.
- Income Tax Act 1961.

Documentation

The nature of documentation varies with every transaction. Typically, the transaction documents comprise the following:

- Loan agreement.
- Inter-creditor agreement.
- Security agreement.
- Non-disposal undertaking and power of attorney (in case of "lock box" arrangements).
- Subscription agreement (in case of equity-linked transactions).

The transaction documents are usually drafted and executed in English.

There are no standard forms of acquisition financing documents. The documents for an acquisition financing usually include the debenture trust deeds and facility agreements in case of debt financing and other subscription and purchase agreements for equity financing. Some banks may have their own format of facility agreement. Further, the Companies Act and its related rules prescribe the format of the debenture trust deed and are governed by regulations from the Securities and Exchange Board of India (SEBI) if listed on a stock exchange.

In addition, the information memorandum or the offering memorandum for the non-convertible debentures must be in a format as prescribed by Companies Act and the various regulations issued by the SEBI.

Seller financing is not common in India and acquisition financings are typically arranged by the purchaser. It is usual to see a funding commitment from the acquirer (which can take the form of a support or commitment letter).

Prior to making the public announcement of an open offer for acquiring shares, the acquirer must ensure that firm financial arrangements have been made to fulfil the payment obligations and that the acquirer is able to implement the open offer (*SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011*).

Vehicles

Many purchasers set up a special purpose vehicle (SPV) or acquisition company in India, which is used to raise money (by debt or equity) for the purposes of financing the acquisition. The financing is raised both by way or debt as well as equity.

However, many Indian acquirers choose to not set up SPVs and may consolidate the acquisition through their company group holding structures. Having said that, investments by foreign owned and controlled SPVs is treated in the same way as with direct investment from a foreign investor.

Equity finance
Typically, straight equity is used for equity financing.

Equity financing is common in India and involves the offer and sale of the purchaser's securities for the purpose of raising the capital to pay the seller. Typically, the purchaser seeks equity from sources such as private equity firms and venture capitalists.

Equity can be brought by purchasing entity or may also include mezzanine debt. In terms of equity, the issuance of compulsorily convertible debentures and compulsorily convertible preference shares is common. However, equity or convertible instruments from private equity players and capital-raising from domestic capital markets are also popular.

Mezzanine financing is a hybrid of debt and equity financing. A mezzanine deal involves a number of structures which incorporates senior and subordinated debt, private-placement transactions and equity investment.

Debt finance

Structures and documentation

Debt financing structures
Indian foreign exchange management laws do not permit external commercial borrowings (ECBs) or the issuance of pure debt instruments by Indian entities for the purpose of acquiring a company (or part of a company) in India, unless the proceeds of the ECB are to be used for either:

- Overseas direct investment in joint ventures/wholly owned subsidiaries established by the Indian company abroad, subject to the guidelines on Indian direct investment abroad.
- The acquisition of shares of public sector undertakings at any stage of disinvestment, under the disinvestment programme of the Government of India.

In relation to acquisition financing by banks in India, the Reserve Bank of India (RBI) guidelines restrict an Indian bank's ability to finance the acquisition of equity shares: a promoter's contribution towards equity cannot be funded by a bank, and banks cannot finance the acquisition of equity shares save for very exceptional cases (as set out below).

Banks can extend loans up to specified limits to corporate against the security of shares held by them to meet the promoter's contribution to the equity of new companies. However, the extension of credit is subject to certain restrictions set out in the Banking Regulation Act 1949 (BR Act) (for example, the bank must ensure that no advances made by a bank are to be used by a borrower to acquire or retain a controlling interest in the company or to facilitate or retain inter-corporate investments). Further, in case any lending is secured through pledge of shares (either of the borrower or its parent entity), banks must conform to BR Act in the event of enforcement of such pledge.

Banks can also finance the acquisition of companies that are engaged in implementing or operating an infrastructure project in India. However, the financing is subject to the following conditions:

- The financing can only be used for the acquisition of shares of existing companies providing infrastructure facilities. Further, the acquisition of the shares should be in respect of companies where the existing foreign promoters (and/or domestic joint promoters) voluntarily propose to disinvest their majority shares in compliance with the guidelines issued by Securities and Exchange Board of India (SEBI) (where applicable).
- The companies to which the loans are being extended must have a satisfactory net worth.
- The company financed and the promoters/directors of such companies must not be a defaulter to the banks/financial institutions.
- To ensure the borrower has a substantial stake in the infrastructure company, the bank finance must be restricted to 50% of the finance required for acquiring the promoter's stake in the company being acquired.
- The finance being extended can only be used against the security of the borrower's assets or the assets of the company being acquired and must not be against the borrower's shares or the shares of the company being acquired. The shares of the borrower or company being acquired can be accepted as additional security but not as primary security. The security charged to the banks should be marketable.
- The duration of the bank loans must not be for longer than seven years. However, the bank's boards of directors can make a specific exemption if necessary for the financial viability of the project.
- The financing must comply with section 19(2) of the BR Act, according to which banks cannot hold more than 30% equity in any company.
- The bank's financing acquisition of equity shares by promoters should be within the regulatory ceiling of 40% of their net worth as at March 31 of the previous year for the aggregate exposure of the banks to the capital markets in all forms (both fund based and non-fund based).
- The proposal for bank finance should have the approval of the bank's board of directors.

Aside from promoter financing (*see above*), debt financing for equity investment or acquisition is also permitted under the following routes:

- **Foreign portfolio investment.**
  A new class of investors called foreign portfolio investors (previously known as foreign institutional investors) have been permitted by the SEBI under the SEBI (Foreign Portfolio Investors) Regulations 2014. Offshore entities registered as foreign portfolio investors can subscribe to:
    - rupee denominated non-convertible debentures and various other instruments;
    - listed (or due to be listed) shares;
    - mutual funds units; and
    - government securities.

The power to register foreign portfolio investors has now been delegated to specific depository participants (many international banks have been registered). The regulations do not restrict acquisition finance/ Therefore, foreign portfolio investors can finance companies in India for the purposes of acquisition.

- **Financing by eligible entities.**
  Various domestic entities (such as mutual funds and private equity players) can provide financing by subscribing to non-convertible debentures (NCDs) that are issued by Indian acquiring companies. Since there is no restriction on the end use, the proceeds of NCDs can be used for the purposes of acquisition in India.

- **Financing by non-bank financial companies (NBFCs).**
  An NBFC is a company registered under the Old Companies Act that is engaged in the business of loans and advances or the acquisition of shares/stocks/bonds/debentures/securities issued by government or local authority or other marketable securities. NBFCs can provide financing for acquisition in India. This practice has evolved in recent times and, unlike banks, NBFCs are not heavily regulated and can engage in corporate finance transactions such as promoter financing and acquisition financing.

The restrictions on acquisition finance have led to the establishment of offshore lending mechanisms in which special purpose vehicles (SPVs) are set up outside India to raise funds offshore for making acquisitions in India. This has led to an increased use of hybrid financing products (such as compulsorily convertible instruments, warrants, and so on).

These hybrid products are also common for listed companies, since by using these instruments, the financier can gain both:

- The benefits of a fluctuating capital market by phasing out conversions.
- Public offer risks related to indirect acquisition of substantial shares or voting rights in the listed target company.

Back-up financing instruments such as guarantees, stand-by letters of credit, keep-well agreements and so on are usually used where either the:

- Financier is a group company or a multinational bank catering to the group.
- Actual interest of the financier is in a parallel transaction.

However, despite the above, it is needless to state that financing an acquisition through equity remains the preferred option, subject to certain commercial and tax considerations.

Restrictions on debt financing
Under Indian foreign exchange laws, the following are not permitted at price that is lower than the prevailing market price, computed according to the guidelines from the RBI:
- The issuance of equity.
- The conversion of convertible instruments into equity in favour of non-residents.
- The transfer of equity from a resident to a non-resident entity.

Further, there are restrictions on the maximum maturity period allowed in case of convertible instruments issued by listed companies. The maximum maturity period for a convertible instrument issued by a listed company is:

- 18 months in the case of preferential allotment.
- 60 months in case of qualified institutional placement.

Furthermore, in the case of listed companies, the extent of conversions undertaken can have open-offer implications for the acquirer.

Mezzanine financing

The nature of mezzanine financing in India has recently undergone some changes. Earlier, optionally convertible preference shares and debentures were treated as equity for the purposes of foreign exchange laws, therefore taking them out of the purview of the ECB guidelines. However, under certain clarifications issued in 2007, optionally or partially-convertible preference shares and debentures are now recognised as ECB, and accordingly, in cases where an ECB is not permitted, such instruments are being avoided for providing mezzanine finance. Compulsorily convertible instruments with equity kickers (such as warrants, preference shares, and debentures) have become common for offshore mezzanine financing.

Inter-creditor arrangements

Inter-creditor arrangements are fairly common in India. Inter-creditor agreements provide for the rights and arrangements of the various classes creditors as between themselves. Typically, inter-creditor agreements are governed by Indian law and the borrower is not included in such arrangements. However, the borrower signs a confirmation letter agreeing to be bound by its terms. An inter-creditor agreement sets out the ranking and the sharing of proceeds between various lender groups, voting by lenders, waivers and decisions including decisions in relation to defaults.

Contractual subordination

Contractual subordination is possible and common in Indian lending transactions. Contractual subordination occurs when a junior creditor agrees that his debt will rank behind the senior creditor. For this purpose, the parties often execute a subordination agreement or stipulate the terms of subordination in an existing financing document. Under the subordination agreement or terms of subordination, the junior creditor agrees that his debt will not be due and payable until the senior creditor's debt is repaid. Alternatively, creditors can enter into an inter-creditor agreement setting out the ranking of debt. Typically, in Indian lending transactions, shareholder/promoter loans are unsecured and subordinated.

Structural subordination

Under structural subordination, the junior lenders lend to a holding company and senior lenders lend to one or more of the operating subsidiaries of the holding company. Structural subordination is common in leveraged financing. Usually, lenders do not prefer this structure because the lenders want security over the assets of the operating company, before the same are distributed to the holding company. Less commonly, however, in a mezzanine debt financing, subordination does take place in the form of structural subordination. In all other cases, lenders prefer structured subordination coupled with contractual subordination agreements.

Payment of principal
Individual repayment mechanisms are typically not addressed in an inter-creditor arrangement.
Inter-creditor arrangements in India also do not work on the principles of agency or turnover in relation to repayments. If a creditor receives an amount over and above its entitlement under the financing documents, the creditor must turn the amount over to the other creditors on a pro rata basis unless there is a preference or priority.

Interest
Inter-creditor agreements do not deal with interest payments. If a creditor or agent receives excess payment of interest it must turn it over to the other creditors in the order of priority set out in the inter-creditor agreement.

Fees
Inter-creditor agreements do not deal with the payment of fees. Further, a creditor or agent receiving excess payment of fees must turn it over to the other creditors in the order of priority set out in the inter-creditor agreement.

Sharing arrangements
In an inter-creditor arrangement, all payments made by the borrower are usually shared pro rata among the creditors in proportion to their outstanding credits under the relevant financing documents or as per their ranking of security. Furthermore, all proceeds from security enforcement are usually shared pro rata unless there is a preference or a priority that is contractually agreed between the creditors.

Claw-back arrangements are common in India. In the event a creditor receives payment to which they are not contractually entitled, a turnover or claw-back arrangement ensures that creditors get their distributions in the order of their priority.

Subordination of equity/quasi-equity
Equity and quasi-equity are usually subordinated. Distributions on equity and quasi-equity and repayments are not usually permitted before the senior debt is paid in full to the satisfaction of the senior creditors and these arrangements are typically covered in the accounts agreement.

Secured lending

Extent of security
An acquirer's ability to acquire shares by leveraging locally within India is restricted due to the following:

- The rules against financial assistance restrict Indian target companies that are public companies from making its assets available as security for the acquisition of its own shares or shares of its holding company (*section 67, Companies Act*).
- The Reserve Bank of India (RBI) imposes minimum requirements on the resources and liquidity of domestic banks and places limits on the amount of their exposure to capital markets.
- Investing companies with foreign investment or foreign owned operating investing companies are prevented from leveraging funds from the domestic market for making downstream investments in India.

Financing used for the purposes of an acquisition can be secured by the assets of the acquirer. Further, guarantees can be provided by a sponsor of the acquirer subject to compliance with the provisions of the
Companies Act. Any pledge of shares of an Indian company in favour of a non-resident entity is not possible without RBI approval. The acquirer/group company can provide security for the non-convertible debentures (NCDs) issued for acquisition.

Further, Indian law does not permit transfer of immovable property in favour of a non-resident entity, except in certain specified circumstances.

Types of security

Shares.
Security over shares or other financing instruments is created by way of a pledge. A pledge over shares is created through:

- A written instrument coupled with a power of attorney in favour of the pledge.
- Delivery of possession of the pledged shares or other security, with the delivery of share certificates or other documents evidencing that the security has been pledged.

Additionally for dematerialised shares, relevant forms will have to be filed with the concerned depository participant.

Inventory.
Security over inventory is created by way of a deed of hypothecation.

Bank accounts.
Security over bank accounts is created by way of a deed of hypothecation.

Receivables.
The most common forms of security over which claims and receivables are usually granted include:

- Contractual rights.
- Insurance proceeds.
- Rights under clearances and authorisations.
- Trade receivables.
- Cash flows.
- Income-related receivables.

Claims and receivables are secured by way of an assignment, subject to restrictions set out in the underlying contract (the rights under which are being assigned). Assignment of receivables/rights under a contract can be made in favour of an assignee by way of a hypothecation or mortgage.

Intellectual property rights (IPRs).
Trade marks, logos, patents, geographical indications, copyrights and designs are the common forms of IPRs over which security is created. Security over IPRs can be created by way of an assignment, hypothecation (movable property mortgage) or charge.

Real property.
Real estate includes land, leasehold rights and anything attached to the earth or permanently fastened to anything attached to the earth. It also includes buildings, appurtenances, fixtures, right to way or any other benefit arising out of land. Security over real estate or immovable property is created by way of a mortgage.

Section 58 of the Transfer of Property Act 1882 (TP Act) defines a mortgage as the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt or the performance of an engagement which may give rise to a pecuniary liability. Section 58 of the TP Act provides for various kinds of mortgages (such as simple mortgage, mortgage by conditional sale, usufructuary mortgage, English mortgage, mortgage by deposit of title deeds and anomalous mortgage).

However, the two most common types of mortgages used in India are the:

- English mortgage.
- Mortgage by way of deposit of title deeds.

Movable assets.
Tangible movable property includes all movable assets including but not limited to plant and machinery (not attached to the earth), vehicles, shares, movable furniture, aircraft, vessels and movable fixtures. Tangible movable property can be secured by mortgage, hypothecation, charge, lien or pledge.

Guarantees

Domestic investment.
Under section 186 of the Companies Act, no company can (directly or indirectly) make a loan to a body corporate, provide a guarantee or security in connection with a loan made by or to a body corporate, or acquire by way of subscription, purchase or otherwise the securities of any other body corporate, if this will exceed the higher of either:

- 60% of its paid-up share capital, free reserves and securities premium account.
- 100% of its free reserves and securities premium account.

In order for a loan, guarantee or investment in excess of these limits to be furnished or made, it must be approved by special resolution of the shareholders in a general meeting. Section 185 of the Companies Act permits a holding company to provide any loan or guarantee or security to its wholly owned subsidiary, subject to its end-use restriction. However, no security (including a guarantee) can be provided with a view to secure the loan assumed by a parent for the purpose of acquiring shares in the company providing the security.

Overseas investment.
Subject to the restrictions set out above, an Indian entity can extend any form of guarantee (whether a corporate or personal/primary or collateral/guarantee by the promoter company/guarantee by group company, sister concern or associate company) in India to an overseas entity in relation to an entity in which it has an equity stake, provided all of the following apply to the guarantee (automatic route):

- All financial commitments (including all guarantees provided by the party) are within 400% of the net worth of the Indian party.
- The guarantee is not "open ended".
- Reporting requirements are complied with.

Prior approval from the RBI is required if any of the above conditions are not satisfied. In addition, approval from the RBI would be required for any financial commitment in excess of US$1 billion (or its equivalent) in a financial year even when the total financial commitment of the Indian Party is within the eligible limit under the automatic route (that is, within 400%).

Security trustee
Security trustees are recognised and frequently used in financings.

Restrictions

Thin capitalisation
India does not have any specific rules in relation to corporate thin capitalisation. However, the Indian tax authorities have recently woken up to this legal black hole and thin capitalisation rules are therefore expected to be part of a new tax code.

The external commercial borrowing (ECB) guidelines (provided by the Reserve Bank of India (RBI)) act as a check on excessive leveraging of Indian companies by offshore lenders. The ECB guidelines not only provide the permissible quantum of long-term and short-term debt, but also affix the maximum permissible interest rate in relation to such debt.

The Indian government intends to introduce the general anti-avoidance rules (GAAR) with effect from 1 April 2017, which will incorporate the concept of thin capitalisation. However, GAAR does not include any capital gearing ratio, unlike typical thin capitalisation regulations. Instead, GAAR characterises debt as equity and vice versa where the arrangement between the parties:

- Is not at arm's length.
- Has less commercial substance.
- Is not carried out for ordinarily, bona fide purposes.

The lack of capital gearing ratio allows discretion of the authorities while it ascertains whether a given capital structure is an impermissible avoidance arrangement.

The development of multinational trade and commerce has triggered the growth of transfer pricing guidelines in India. The Indian transfer pricing guidelines regulate rate of interest payable in relation to certain foreign transactions involving "associated enterprises". Under these guidelines, Indian tax authorities can reset the interest rate in a loan transaction between two or more associated enterprises if the agreed interest rate is not affixed on arms' length principles.

However, it should be noted that these guidelines do not place any restrictions on the quantum of permissible debt, and merely seek to regulate erosion of state revenue by entities reducing their corporate taxable income.

The concept of an advance pricing agreement (APA) has existed in India since 1 July 2012. APA is an arrangement between the taxpayer and the tax authority which covers future inter-company transactions with a view to resolving the potential transfer pricing disputes in a co-operative manner. The APA rules do not prescribe any threshold for the application. This mechanism is unavailable for specified domestic transactions. The biggest advantage of APA is that it provides certainty win relation to the outcome of a covered transaction during the term of the APA, which is five years.

Financial assistance

In addition to the restrictions on creating security over Indian assets (see *Question 8, Extent of security*), there is also a general prohibition on public companies from giving any financial assistance (whether directly or indirectly) whether by means of loan, guarantee, security or otherwise for the purpose of or in connection with the purchase or subscription of shares in the company or in its holding company.

Regulated and listed targets

Under the current foreign investment laws, no foreign investment is allowed in the following sectors:

- Lottery business.
- Atomic energy.
- Gambling and betting.
- Real estate business (this includes dealing in land and immovable property with a view to earning profit but does not include the development of towns or the construction of residential/commercial premises, roads or bridges).

However, foreign investment in other business sectors is allowed under either the:

- **Automatic route.**
  Under this route, industries can obtain foreign investment without prior approval from the Government of India or the Reserve Bank of India (RBI). This route includes manufacturing and certain specified non-banking financial companies.

- **Approval route.**
  This requires approval from either the Government of India or the RBI. This route includes sectors such as print media and pharmaceuticals.

The rules relating to foreign investment in India have been significantly liberalised and have brought foreign investment into most sectors under the automatic route.

Sectoral guidelines also set out certain caps on investment, such as a cap of up to:

- 74% foreign investment in the private banking sector.
- 49% foreign investment in the insurance sector under automatic route.
- 26% foreign investment in the print media under the approval route.

Further, former highly-regulated sectors such as construction and development have been liberalised and opened up to foreign investment. Several sector-specific conditions such as minimum area, lock-in restriction for transfers between non-residents have been done away with. Similarly, 100% foreign direct investment under the automatic route is now permitted in the e-commerce sector.

In addition to foreign investment laws, sector specific laws and regulations for investment restrictions or aggregation and "look through" principles, such as in the case of banks, and print media must also be complied with

How does the fact that a target is listed impact on a transaction?

The primary issue for listed companies is the application of the Takeover Code to the acquisition as well as to the financing.

Under the Takeover Regulations, the acquisition of a substantial number of shares or voting rights in the target triggers the obligation to make a tender offer to the public shareholders of the company in any of the following circumstances:

- An acquisition by the acquirer (together with persons acting in concert) of 25% or more of the voting rights of the target.

- When the acquirer (together with persons acting in concert) holds 25% or more but less than 75% of the shares or voting rights of the target acquisition of more than 5% of the voting rights of the target in any financial year ending on March 31 of that year.

- The acquisition of control over the target, irrespective of whether there has been any acquisition of shares or voting rights. The term "control" is broadly defined, and includes the right to appoint directly or indirectly or by virtue of agreements or in any other manner, the majority of the directors on the board of the target or to control its management or policy decisions.

The Takeover Regulations apply to both direct and indirect acquisitions of shares/voting rights and/or control over a target. A mandatory open offer must be made for at least 26% of the voting shares of the target. Unlike mandatory offers, voluntary offers are not triggered by underlying events. Further, the offer size of a voluntary offer can be as low as 10%.

However, the post-acquisition holding of the acquirer in an open offer should not exceed the maximum permissible non-public shareholding. In light of the strict provisions in relation to the open offer requirements under the Takeover Code and the application of these rules even in the case of an indirect acquisition of shares, voting rights and control, acquirers of shares, voting rights or control in an Indian company or those financing the acquirers should be cautious of these provisions and should structure their acquisition and acquisition financing with the threshold requirements in mind.

However, it should be noted that an acquisition of shares by a bank and public financial institution as pledgee is exempt from the open offer requirements under the Takeover Code.

Further, if a listed company intends to raise funds for the acquisition by way of a preferential allotment or qualified institutional placement of convertible instruments, the provisions of the Takeover Code will be only be triggered on conversion of such instruments into equity shares. The convertible instruments will be subject to the pricing norms contained in the ICDR Regulations.

Pension schemes
There is no impact of pension schemes held by the target or purchaser on the acquisition? Not applicable.

Lender liability
Lender liability is generally a matter of contractual arrangement in India. However, in the case of *Mardia Chemicals v Union of India (AIR 2004 SC 2371)* the Supreme Court of India for the first time expressly recognised that lenders have an implied duty of good faith and fair dealing in relation to borrowers.

The Reserve Bank of India (RBI) has also issued guidelines on lender's liability called *RBI Guidelines on Fair Practices Code for Lenders*, which relate to:

- Applications for loans and their processing.
- Loan appraisal.
- Disbursement of loans.
- Post-disbursement supervision.

Debt buy-backs
The shareholders of a company must pass certain resolutions and comply with certain provisions of the Companies Act if they provide any guarantee or security in connection with a loan to any other body corporate or person (*Companies Act*). This also applies to securities (including debentures) purchased by the company.

If the financial sponsor of the borrower purchases debentures of other forms of loans of the borrowers in the secondary market, and if the buy-back is provided for in the underlying borrowing or other documents, this could be considered to be a guarantee from the sponsor to buy-back the loans or securities on the occurrence of an event or completion of a certain time period.
Therefore, the financial sponsor must pass the requisite resolutions and comply with the relevant provisions under the Companies Act.

Post-acquisition restructurings
Post-acquisition restructuring techniques usually depend on the nature and extent of the acquisition being performed.

If the acquisition relates to a business undertaking rather than a share acquisition, the post-acquisition restructuring is typically is based on achieving synergy in business through mergers and combinations, which could assist the acquirer in generating a profit pool for repayment of the financing undertaken for the acquisition. Such mergers are, at times, undertaken with listed entities to achieve access to larger cash flow.

In the case of share acquisitions, acquirers normally wish to consolidate their holdings, which for listed companies could lead to the adoption of minority elimination processes (such buy-back, the issuance of convertible instruments in court-based restructurings, the creation of artificial majority among the minority shareholders for undertaking variation of class rights, undertaking delisting through reverse book building offers and so on).

Debt restructuring in India can be undertaken through either:

- **Court-based mechanisms.**
  This is typically carried out through a creditors' scheme of arrangement under Sections 391 to 394 of the Old Companies Act. The creditors in such a scheme have complete flexibility in proposing a debt restructuring mechanism, subject to the same being approved by at least a majority of the creditors representing 75% in value of the creditors, and shareholders of the company present and voting.

- **Out-of-court mechanisms.**
  These include the strategic debt restructuring (SDR) scheme notified by the Reserve Bank of India (RBI) in 2015. Previously in its circular dated 26 February 2014 on Framework for Revitalising Distressed Assets in the Economy: Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan, the RBI envisaged change of management as a part of restructuring of stressed assets.

  However, owing to certain operational/managerial inefficiencies, change of ownership through Strategic Debt Restructuring was introduced by the RBI in its guidelines dated 8 June 2015.

  The RBI now allows banks to undertake SDR of stressed assets by converting loans due into equity shares. The initiation of SDR and the applicable process must be in accordance with the SDR scheme.

Reform

The Insolvency and Bankruptcy Code 2016 (Code) was recently passed by the Indian Parliament and will soon come into force. The Code will impact acquisition financing transactions in India.
The Code is based on a revival model for companies and limited liability partnerships. Therefore, once a corporate debtor defaults in the repayment of debt (with a minimum threshold of US$1,500), a corporate insolvency resolution process can be initiated. Once this commences, a moratorium is declared on the initiation of legal proceedings and enforcement of security and termination of contracts (among other things).

At the end of the corporate insolvency resolution process, a resolution plan setting out the scheme of revival of the corporate debtor is presented which must be approved by the committee of creditors and the adjudicating authorities. Once approved, the plan is binding on all stakeholders, debtors and the promoters of the company. As part of the resolution plan, angel investors may be keen on acquiring the stressed company. Further, certain creditors may be keen on rescue financing in order to revive the stressed company. The Code therefore provides more opportunities for acquisition financing in India.

According to a draft circular recently issued by the Reserve Bank of India, foreign portfolio investors can invest in primary issuances of non-convertible debentures (NCDs) provided the issuing company does not use the borrowing proceeds for:

- Real estate activities.
- Land purchases.
- Investing in capital market.
- On-lending.

Previously, foreign portfolio investors could only invest in unlisted NCDs in the infrastructure sector. This will expand options for acquisition financings and will boost the corporate debt market in India.

Mergers And Acquisitions – Transactional Challenges In India

Mergers and acquisitions ("M&A") are primarily used by companies looking to scale up and grow their businesses. "Mergers" are generally understood as events that result in target entities ceasing to have separate corporate or legal identities and being subsumed into the acquirors, while "acquisitions" are generally understood as events where target entities are acquired but continue to retain their distinct corporate and legal identities. While there are several types of acquisition transactions possible, this article focuses on transactional challenges with respect to acquisition by way of purchase of shares with an emphasis on cross-border M&A transactions in India.

Merger "and" acquisition of an Indian company

While the terms "merger" and "acquisition" are often used synonymously and as part of the same phrase i.e., "M&A", the distinction between a merger and an acquisition as stated above needs to be kept in mind. Under Indian law, cross border merger of an Indian company into a foreign company is not permissible, while a cross border merger of a foreign company into an Indian company or merger of two Indian companies, is permissible. An acquisition of an Indian company by a foreign company, or another Indian company is permissible as is an acquisition of a foreign company by an Indian company.

Due diligence process and its challenges

In an acquisition, the process of conducting an effective legal due diligence ("LDD") cannot be underestimated. Unlike a private equity transaction, the erstwhile shareholders exit as part of the acquisition. Undertaking a comprehensive assessment of the business, regulatory, environmental and legal risk factors involved in acquiring the company is critical.

In India, the LDD process commences with a review of data that is provided by the target company itself. Data except in a few instances is not publicly available and even if available may not be updated or carry any statutory or regulatory certification, especially in critical aspects such as property ownership, share ownership and litigation. India does not have a Government backed title registry which serves as conclusive proof of ownership.

As such, no counsel can conclusively certify the status of the company and any diligence is therefore dependent on the quality and integrity of data being made available. Additionally, the closing of an acquisition transaction is often delayed requiring bringdown diligence procedures for the period between the date of completing the LDD and the closing date.

In India, LDD generally does not cover financial and tax matters (both direct and indirect tax) and often there are separate firms engaged for financial due diligence ("FDD") which includes taxation and accounting matters. To effectively understand the risks, it is critical for the acquiror to view the findings of LDD and FDD on the target company as a whole. It also becomes important for legal counsel of the acquiror to understand FDD findings and to be able to effectively draft legal provisions for relevant FDD findings in the transaction documents.

The standards of corporate governance and regulatory compliance may often fall short of the expectations of foreign acquirors. This is especially so in areas such as board independence, environment, labour, related party transactions and formalisation of arrangements with key customers and suppliers.

Valuation differences occurring because of differences in accounting or revenue recognition standards between those used by the company prior to the acquisition and that applied by the acquiror post-acquisition also become contentious, particularly in the case of an acquisition that is consummated in tranches.

Representations, warranties and indemnities

In an acquisition, a representation or warranty provided by the target company has little meaning. Accordingly, an acquiror would look to the selling shareholders to provide necessary representations and warranties. While warranties on title to shares, non-encumbrance, ability to contract, etc., are not negotiated heavily, there are often detailed negotiations surrounding operational warranties. In cases where there are individual shareholders selling their shares in the company, these are easier to obtain.

However, where selling shareholders are financial investors such as funds, warranties on operational matters will not be readily forthcoming with necessary comfort being restricted to due diligence findings and the satisfaction of conditions precedent. The need for robust warranties on business operations are magnified in cases of companies that operate within regulated sectors and companies engaged in activities with significant potential for tortious liabilities.

Foreign acquirors also seek to obtain comfort on matters that fall within the reach of foreign laws that may be applicable to the acquiror (and not necessarily to sellers or target company) such as FCPA/ anti-bribery laws and ESG matters.

Indemnities are typically difficult to enforce in India as under Indian law, indemnities are akin to damages and are required to be proved. Liquidated damages tend to be capped even when there is a genuine pre-estimation of losses. Even where indemnities are established, foreign parties may face difficulties in repatriation of sums awarded outside India and may in some instances need regulatory approval.

Holdbacks, and escrow

Earlier, Indian regulators would not permit holdbacks, escrow and deferred considerations. Recent changes and liberalisation in the legal position have enabled deferred consideration and escrows albeit to a limited extent. While this may not grant complete freedom in structuring transactions, there is a move to ease restrictions and allow greater flexibility on contractual restrictions as opposed to regulatory restrictions.

It is however important for acquirors to work closely with banks (Authorised Dealers of foreign exchange) in India and to whom a large amount of regulatory discretion has been delegated by the Reserve Bank of India (RBI) to ensure that structures pass muster.

Regulatory and other approvals and costs

For a merger between two Indian companies, approval of the relevant court (jurisdictional Company Law Tribunal) as well as approvals from the Registrar of Companies, income tax authorities, creditors and shareholders may be needed. For an acquisition, the need for and timing of regulatory approvals to be obtained depend on the nature of activity of the target company, its status (private or publicly listed) and its turnover and asset threshold.

In general, the acquisition of a mid-size knowledge-based services company (such as information technology) that is privately held, would require minimal regulatory approvals. For publicly held large companies, approvals from multiple regulators such as the Securities and Exchange Board of India (SEBI), RBI and the Competition Commission of India (CCI) may be required.

Costs of obtaining such approvals are usually borne by the acquiror but these are sometimes negotiated such that these costs are factored into the transaction consideration. Approval of other regulators for change in control is often necessitated in companies that have been allotted land by the Government or which enjoy certain specific benefits and exemptions.

Execution of definitive agreements and transfer of shares involves the payment of stamp duties which vary across different states in India. These costs are normally to the account of the acquiror but again can be negotiated and factored into the purchase price.

Other considerations

Non-compete clauses while quite common in transaction documents are subject to interpretation on enforceability. Acquirors therefore adopt complicated structures to work around this by entering into consulting agreements with exiting promoters to bind them to exclusivity and non-compete arrangements that may also have the effect of assisting in the transition. Acquirors are also often surprised by the transaction costs which are contractually agreed to by the company such as investment banking, financial advisor and legal counsel fees.

Summary

While M&A transactions in India are not atypical, there are certain nuances in doing business in India which may be unique to the geography.

Foreign acquirors would do well to understand that often Indian promoters are not well equipped to understand clauses such as indemnities, warranties and conditions precedent.

Explanation and education of clients about transaction intricacies could add to timelines. Simplifying documentation and structures works best.

Often promoters do not separate their personal assets from the company’s assets and often promoter’s houses, cars, etc. are all owned/registered in the name of the company.

Promoters would lose access to all these consequent to a sale of the company. Transfer of such assets prior to completion of the acquisition would have cost, tax and time consequences.

Any M&A in India therefore needs to be undertaken understanding not just the legal and regulatory regime but also certain cultural issues specific to India and engagement of experienced advisors is a *sine-qua-non* in these matters.

Cross Border Mergers & Acquisitions: Recent Trends in India

This is been happening in India for the first time that the people of this country are talking about something very rare to be discussed in India. People often go for several discussions over lot of things but the topic which is now on the tongue of every person is not one of their favourite issues like Cricket, Politics, Movies or Mismanagement by the Government in Country, rather is about the growth, the growth- of Indian Companies, of Indian Economy and of India's reputation in the Economic world of this globe.

Look what is actually happening, our corporate leaders are grabbing the foreign corporations or going for partnership deeds if not capable of buying them and this is nothing but the magical change in our corporate world because of which we now dare to go for acquisitions of foreign companies or they are themselves eager to combine with us. This is the latest trend developing between Indian Incorporations to grow faster by the way of Takeovers or Merger with other big players. There is not a single company but a list of companies, which are really looking forward to get their goals.

The question that arises here is what are the reasons for this drastic and sudden change? The answer is that there are several factors working behind this change and in this essay we are trying to bring out some of the most important driving factors of the recent trend of the Indian companies becoming global leaders and this time they have chosen the path of Mergers and Takeovers out side the border.

Amalgamations can primarily be of two types, Mergers and Acquisitions. A merger can be defined as an amalgamation of two or more companies into one, wherein the merging entities lose their identities. No fresh investment is made through this process. However, an exchange of shares takes place between the entities involved in such a process. Generally, the company that survives is the buyer that retains its identity and the seller company is extinguished.

On the other hand, an acquisition or takeover is aimed at gaining a controlling interest in the share capital of acquired company. It can be enforced through an agreement with the persons holding a majority interest in the company's management or through purchasing shares in the open market or purchasing new shares by private treaty or by making a take-over offer to the general body of shareholders. In this process only one company loses its identity that is the seller company.

A finer appreciation of this point need be emphasized. A takeover, which is essentially an acquisition, differs from a merger in its approach to business combinations. In the process of takeover, the acquiring company decides the maximum price that is to be offered to the acquired firm and hence takes lesser time in completing a transaction than in mergers, provided the top management of the acquired company is co-operative. In merger transactions, the consideration is paid for in shares whereas in a takeover, the consideration is in the form of cash. In a merger, a new entity may be formed subsuming the merging firms, whereas in an acquisition the acquired firm becomes the subsidiary of the acquirer firm. However, mergers and takeovers can be treated as similar processes, since in both cases at least one set of shareholders looses executive control over a corporation, which they otherwise held.

There have been a series of merger waves, witnessed in many of the market-oriented economies. There have been three major merger waves in the United States during the periods 1887-1905, 1916-1929, and post-world war II. In constant dollar terms, the mergers during 1988 increased almost four to six times more than the value of mergers in the early seventies. The other developed countries such as the UK, Canada, France, Germany and Japan have also witnessed periods of a sharp rise in merger activity, although the US has been the most active mergers market.

The trend in India has been that mergers between large business firms have been negotiated and concluded right through the post-Independence period in India but they have been very rare and exceptional. In 70's a number of changes were effected in the government's policies and these changes were heralded, inter alia, through the abolition of the managing agency system, the passage of the MRTP Act 1969, the nationalization of the banking system in 1969 and the announcement of new provisions granting tax relief in the Finance Bill for 1967. All these initiatives were aimed at curtailing the power of the big business houses and dealing with the adverse consequences of the absence of price competition among the established business groups. They therefore affected the process of growth through mergers as well.

As a result of this, mergers and acquisitions were very rare in India during 70's and 80's. Only 15 takeovers among MRTP companies were done during 1980-81 to 1984-85 and then in 1985-86 to 1989-90 this figure was 91. The reason for this low rate of mergers and acquisitions was the Government's view of non-allowance of monopolization and as a result it passed MRTP Act, 1969 whose Chapter III placed a bar on mergers and acquisitions, within and outside India.

But the picture changed in 1991 when the Indian government changed its view and entered into the era of liberalization and dissolved the whole chapter III of the MRTP Act and liberalized the other rules relating to the mergers and acquisitions present in the Companies Act, 1956 and that of RBI. And thus the removal of institutional barriers encouraged a few more Indian companies and foreign firms to redefine their portfolios and reformulate their corporate and business strategies through the merger and takeover process. And it was from hereon that the trend of cross border mergers and takeovers gradually started taking its shape. But in 90's a few large corporations dominated the merger movement.

All this was a motivation and encouragement for the foreign firms to set up and build their operations in India. In fact, it has been argued that one of the reasons for the increase in mergers during the 1990s was the keenness of international firms to exploit this opportunity, which in some instances is furthered through mergers with existing operators rather than through the establishment of Greenfield projects. The 1990s have been years in which foreign direct investment flows into India have risen from less than half a billion dollars to more than 3 billion dollars a year. Interestingly, one aspect of it has been the role of rising cross-border mergers and acquisitions in explaining the cross-border flows of capital. But it needs to be noted that the presence of foreign firms among merging entities is visible only after 1992-93. This could be because the relaxation of FERA regulations occurred in January 1992, when foreign companies were allowed to open branches, permitted to use their trademarks, carry out any activity of a trading, commercial or industrial nature, borrow money and accept fixed deposits like any other Indian company.

The most important fact emerging here is that in 1990's either the merger or takeover is done within India by the Indian Companies or the foreign firms are coming here and merging with the Indian companies, but the Indian companies are not moving out of India and entering into mergers and acquisitions with the foreign companies.

Looking up in to the legal or statutory constraints of amalgamations we see that the process of mergers or takeovers in India is governed by the sections 391 to 394 of the Companies Act, 1956 and requires the following approvals:

Shareholder Approval
According to the Indian Companies Act, if the acquisition value exceeds 60 per cent of the Indian company's net worth or 100 per cent of it's free reserves, and then the Indian company is required to take prior approval from its shareholders for making the investment in the target company.

High Court Approvals
The company must take approval of the High Court of that state in which the registered office of the company is present.

Reserve Bank of India Approval
According to the current RBI regulations, companies cannot bid for an overseas acquisition under the automatic route, if the total funds required for the acquisition exceed 200 per cent of the Indian company's net worth. There are several other aspects, which need to be looked at to determine if the proposed acquisition falls within the 200 per cent limit

SEBI's Takeover Code for substantial acquisitions of shares listed in Listed Companies
On 4th November 1994, SEBI announced a take-over code for the regulation of substantial acquisition of shares, aimed at ensuring better transparency and minimizing the occurrence of clandestine deals. In accordance with the regulations prescribed in the code, on any acquisition in a company, which makes acquirer's aggregate shareholding exceed 15%, the acquirer is required to make a public offer. The take-over code covers three types of takeovers-negotiated takeovers, open market takeovers and bail-out takeovers.

With the beginning of 21st century we have witnessed a new era of development and liberalization, as there is a remarkable and consistent growth in Indian economy. All this has lead to a significant growth in the structure of Indian Companies with further eagerness to grow faster to compete with others, whether within India or outside our borders and hence the companies have switched over to some new methods of expansion and restructuring, and takeover or merger is the latest method chosen by our companies to be parallel with foreign companies.
We can say it as a new era of liberalization after early 90s when we have started our economic reforms. To see the real picture we have to look at few remarkable takeovers and mergers by our companies which lead to the beginning of a new era.

These acquisitions have grown tremendously in last five-six years; the research of FICCI has shown that in between 2000 to 2006 there have been 307 acquisitions amounting to more than Rs 90,000 crores. And the reality is that the number of these deals is increasing and similarly there are several mergers also taking place with the foreign companies in various fields. The size of the companies is also increasing with a great velocity and we can say that no one can stop India because now we are also capable of grabbing others and ready to take risks.

Indian companies had spend $20 billion to fund the 147 mergers and acquisitions deals abroad in 2006, according to Dealogic. In comparison, such deals in 2005 accounted for less than $5 billion, with 45 M&A deals.

The biggest contributor to 2006's deals was the Tata - Corus deal which was valued at about $9.8 billion. This was followed by ONGC's $1.4 billion takeover of Campos Basin Oils Fields and 50 percent stake in Omimex de Colombia ranked second and third biggest deals. United Breweries $0.75 billion offer for UK-based distiller Whyte & Mackay and the takeover of Daewoo Electronics by Videocon for $0.72 billion formed the top five deals.

Among other publicized deals,

- Tata Motors bought South Korean company Daewoo's truck plant in that country.
- Reliance Infocom took over Flag International, a major telecom network, for US$211 million. The deal gives Reliance access to 50,000 kilometers of fiber optic network worldwide.
- Software giant Wipro Ltd has acquired US-based consulting company Nerve Wire for $18.7 million even as it's contemporary, Infosys Technologies, snapped up Australian software firm Expert Information Services Pty Ltd for $23 million.
- Meanwhile Sundram Fasteners Ltd, an auto ancillary manufacturer based in south India, has acquired Dana Splicer Europe, the British arm of a global multinational corporation (MNC) that supplies leading automotive giants like Volvo and Scania.
- Pharma major Ranbaxy has purchased RPG Aventis, the French generic wing of multinational Aventis.
- Cadilla Healthcare has bought the formulations business of another French company, Alpharma.
- Mahindra Group has picked up a majority stake in California-based technology consulting and services firm Bristlecone.
- And Hindalco, a flagship company of the $6 billion Aditya Birla Group, has acquired two copper mines in Australia for $68 million.

In the last five years, industry leaders like Wipro, TCS, Ranbaxy, Bharat Forge, Mahindra & Mahindra and Genpact, have acquired companies abroad at a regular intervals in a bid to get market access, technological know-how or acquire new skills. And now it's not only the mid-rung companies with strong domestic market share, solid cash flows, and good management that have joined the outward-bound group, but even those without a hefty bank balance are looking out. "Today everybody is looking at international markets.

Even the smaller companies are asking themselves the question, 'Why am I defining my market as only India,'" says Abhijit Bhaumik, director, Opus Advisory, a boutique advisory firm. And this is not the limit because we are going to see a new era, an era of

Indian companies being global with new goals to defeat others anyhow. And this is the reason why cross border mergers and takeovers are started to be called as recent trend.

There are several tie ups also taking place where Indian and foreign companies are coming up with joint ventures like Ranbaxy and other pharma companies are doing, but the recent and most remarkable deal is between Mahindra and Mahindra of India coming together with Renault, a big player in world of automobiles.

This is the real picture of changing face of Indian corporate world because the conditions are really favourable for fulfilling their goals of expansion and restructuring.

With all these changes the views about Indian economy are also getting changed because we not only have consistent high GDP growth but we have also got approval as a big player in world economy. Foreign investors are now eager to enter in Indian market with lot of funds because they are sure about the growth and this is been shown by our high speed of growth in the share market. Due to the confidence in India the whole globe is looking towards us and they are now turning out in large numbers which makes our foreign currency stocks big and strong as never, this enables us for looking at new goals and hence our public sector companies are also going for mergers and acquisitions as private ones.

Along with these new achievements we come across some challenges as to run the acquired companies properly, which is not an easy task, because these mergers and acquisitions may affect the working of these companies adversely. There are financial problems also because we are acquiring companies bigger in the size and capital, every one is not quite capable as TATA to get funds from market that much easily because for that one has to prove its capability in handling these kinds of business deals.

There is one another problem in west, they never want any Indian or Asian company to grab their market and hence they generally oppose such deals, as evident from Arcellor-Mittal deal. Hence we also have to acquire their faith and support along with acquisition of their companies.

The conclusion of the essay is that we had several adverse situations in the past in emerging as a global leader in economic sector because we hadn't gone for liberalization and afterwards when we opened our doors for outer world they entered slowly due to hesitation about our policies and growth in our market because we were progressing at very low rate. Our companies were also bound by several obligations while entering outer world but when the situations got favourable then they choose to grow and expand beyond the borders. Though it had started with a low pace but now we have got the right pace and environment to grow ourselves according to the desires and hence our corporate world has chosen the magical formula of merger and acquisition which enables them to mark their global presence with comparatively easy way, as in this manner they get a readymade manufacturing unit, prior market and distribution network, which are very difficult when anyone goes for establishment of a new unit.

Hence now our companies are becoming global by way of cross border mergers and acquisition which has developed into a recent trend, where we have gone for tie-ups and acquisitions to grow ourselves according to the need of a true global economy.

Module IV: Technicalities of Mergers & Acquisitions

Mergers & Consolidation as per Companies Act
The task of enacting a new law to regulate companies in India is complete. The Companies Act, 2013, (“New Act”) in its new avatar, mirrors several changes when compared to the law contemplated under the Companies Act, 1956 (“Old Act”). It brings in a whole new set of expected and unexpected changes to the existing regime governing Indian company law.

Chapter XV of the 2013 Act, Sections 230 to 240 deal with “Compromises, Arrangements and Amalgamations.” In this chapter, the Act consolidates the applicable provisions and related issues of compromises, arrangements and amalgamations; however, other provisions are also attracted at different stages of the process. Merger means combining of two or more entities into one, which results in merger of all the assets, liabilities of the entities under one business. The dissolution of company/companies involved in a merger takes place without winding up. The possible objectives of mergers are manifold- economies of scale, acquisition of technologies, access to sectors / markets etc.

Procedure
The memorandum of association of the companies seeking to merge, should give power to companies to amalgamate. Also, the creditors of the companies must approve the merger scheme. Notice of merger along with merger proposal and valuation report etc. needs to be served upon creditors, shareholders, and various regulators (MCA, RBI, CCI, Stock exchanges of listed companies, IT authorities and other sector authority likely to be affected by merger.) Shareholders and creditors are given option to cast their vote through postal ballot. Tribunal can order meeting of creditors if application is made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement for merger or amalgamation.

Objections can be raised by shareholders who hold 10% or more equity or creditors whose outstanding debt is 5 % or more of the total debt as per last audited balance sheet. Prior certification from auditors saying accounting treatment is in consonance with accounting standards needs to be filed with stock exchanges (for both listed and unlisted companies).

Board of Directors need to approve the draft proposal after which application will be made to respective High Court (State where registered office is located) in Form no. 36. After the approval mentioned above, the scheme will have to be filed with the Official Liquidator, RoC and the Central Government. In the event of there being “no objection,” this will be deemed as approve. The 2013 Act has established National Company Law Tribunal which will handle all the matters related to company law and replace the HCs.
After the Court order, its certified true copies will be filed with the Registrar of Companies.

The assets and liabilities of the acquired company will be transferred to the acquiring company in accordance with the approved scheme, with effect from the specified date. As per the proposal, the acquiring company will exchange shares and debentures and/or cash for the shares and debentures of the acquired company. These securities will be listed on the stock exchange.

Retained provisions
Although substantial changes have been incorporated in the New Act, several key provisions remain unchanged. For example, the acceptance of a scheme or merger or amalgamation by three-fourths of the shareholders, like in section 391(2) of the Old Act, is still a pre-condition to a merger or amalgamation. The power of the Central Government to order a merger or amalgamation in the interest of the nation is untouched and is placed in Section 237.
Further, the obligation to maintain records of the mergers/amalgamations is retained in Section 239 as its importance cannot be ignored. Other matters like convening meetings, obtaining the permission of the regulatory authorities and the Central Government in cases of mergers or amalgamations remain unaltered.

Mergers and Amalgamations: the distinction remains unexplained
While the Income Tax Act 1961 ("IT Act") distinguishes clearly between mergers and amalgamations, the Old Act and the New Act the two are used interchangeably and the procedures for both are identical. Section 234 of the New Act states that the provisions of the New Act shall apply mutatis mutandis to both mergers and amalgamations, thus acknowledging that a merger and amalgamation may be conceptually different but are deemed to be the same for all purposes.

As a result, no statute, except the IT Act, exists to differentiate a merger from an amalgamation, and the reason explained in the IT Act, shall remain to be the sole provision explaining the distinction between a merger and an amalgamation.

National Company Law Tribunal to perform erstwhile functions of High Courts
Under the Old Act, the High Courts were endowed with the power to sanction a scheme of merger/amalgamation. However, as per the provisions of the New Act the power given to the High Courts would be invested with the National Company Law Tribunal (NCLT). This change should help in shortening the time taken in obtaining sanctions in cases of mergers and amalgamations.

Voting through postal ballot
Under the Old Act, the shareholders or the creditors, as the case may be, may be present either in person or in proxy for approving the scheme of amalgamation/merger. The New Act goes a step further and provides another mode of voting. Sub-clause (4) of Section 230 envisions adoption of a scheme under Chapter XV by postal ballot.

Notice of the meetings
Sub-clause (5) of Section 230 of the New Act obligates companies to send a notice of meeting to approve a merger/amalgamation to various government authorities such as Central Government, the Income Tax Department, SEBI, RBI, Registrar of Companies, the respective stock exchanges, the official liquidator, the Competition Commission of India, and if the need be, to any other regulatory authority likely to be affected by the merger/amalgamation for seeking representations from the respective authorities if any within a period of 30 days from the date of receipt of such notice.

Under the Old Act, notices are to be sent mandatorily to the Central Government, Registrar of Companies and Official Liquidator and the concerned stock exchanges. Further, under the Old Act if no report is provided by the authorities then it is not deemed to have been approved. Whereas, as per the New Act, if the representations are not provided within 30 days from the date of receipt of the notice then, it is presumed that the authorities have no representations to make on the proposals.

Further, the ‘thirty days’ requirement might spring up a few procedural inconsistencies For instance, Section 6(2a) of the Competition Act, 2002 allows 210 days for the CCI to pass an order after verifying the proposed merger, whereas the New Act gives only a time period of thirty days to reply for any authority likely to be affected.

Objections to mergers/amalgamations

Sub-clause (4) of Section 230 of the New Act provides that only persons holding not less than 10% of the shareholding; or having not less than 5% of the total outstanding debt can object to a merger/amalgamation. In stark contrast, the Old Act specifies no minimum-ownership-condition to object to a merger/amalgamation. The impact of the New Act is two-fold: genuine claims of shareholders may go unrepresented, while mala fide and frivolous claims will no longer act as dampeners.

An important feature that may delay the merger process is the provision allowing all statutory authorities to intervene in the NCLT process and use this tactic effectively to seek payment of all pending demands, even the disputed amounts.

Merging of listed Co. With unlisted Co.

If a listed company merges with an unlisted company under the Act, then unlisted will by default not become listed. The option is given to the transferee company to remain unlisted till it is listed or applies for listing, provided the shareholders of the merged listed company are given an exit opportunity. It also provides that provision should be made by the NCLT for an exit route for the shareholders of a transferor company who decide to opt out of the transferee company by making payment amounting to the value of the shares and other benefits.

Demerger

Demerger includes transfers, pursuant to the scheme of arrangement by a “demerged company” of one or more undertakings to any resulting company in such a manner as provided in section 2(19AA) of the Income Tax Act, 1961. The rules prescribe that the difference in the value of assets and liabilities in the books of a demerged company will be credited to its capital reserve or debited to its goodwill.

Moreover, the difference in the net assets taken over and shares issued as consideration will be credited to the capital reserve (excess) or debited to goodwill (deficit) in the books of the resulting company.

A certificate from a Chartered Accountant will also be required to be submitted to the NCLT to the effect that the accounting treatment is in compliance with the conditions so prescribed.

Minority shareholders

Minority shareholders are provided with an exit mechanism, when majority shareholders (90% or more) notify their intention to buy shares of such holders. Minority shareholders may also offer their shares suo- motto to majority shareholders. The buyback option will be at the price determined by registered valuer according to SEBI’s regulations.

Indian companies allowed merging into foreign companies
The Old Act allows domestic companies to merge into each other, besides allowing foreign companies to merge into Indian companies. The New Act goes a step further, as it allows foreign companies to merge into Indian companies and vice-versa, meaning Indian companies wanting to merge into foreign companies may press ahead with their intention. The approval of the RBI is a pre-requisite in the both the cases.

However, by virtue of Section 234 of the New Act, the license to merge into foreign companies comes with a rider that Indian companies can only merge into foreign companies domiciled in any of the jurisdictions notified by the Central Government.

Fast Track Mergers
Under the Old Act, mergers/amalgamations between group companies and subsidiaries are placed on the same pedestal on which mergers/amalgamations between entirely unrelated companies are placed. This meant that, mergers between group companies, and subsidiaries have to also conform to the normal procedure.

However, under the New Act, Section 233 allows mergers between two small companies and holding companies and their wholly owned subsidiaries may not have to go through the normal procedure. Mergers/amalgamations may be completed, if the official liquidator and the members approve, and if sanctioned by the Central Government, without having to wait for the order of the NCLT confirming the merger/amalgamation. This leeway helps cut costs involved in complying with the procedures, saves time and simplifies the procedure of mergers between two small companies or wholly owned subsidiaries and their parent companies.

Takeover offers
Under the Old Act, no takeover can be a part of any Compromise or Arrangement involving a merger or amalgamation. But, under the New Act, a scheme of compromise or arrangement involving a merger/amalgamation may include a takeover offer. Thus, the Central Government is to promulgate rules to govern the takeover offers that may be announced as a part of a merger/amalgamation or change the Takeover Code to suitably govern the takeover offers that may be made under this section.

Summary
It appears that the New Act can help deal with the challenges and complexities that the current procedures faces in relation to procedures that were contemplated under the Old Act. The New Act has incorporated various provisions to tackle the problems actually faced in the process of mergers, by taking into consideration the practical aspects of the process. It is an attempt to fine tune the process by making it more efficient and in-turn effective. The New Act no doubt has some ambiguities attached to it, which would need to be sorted out in order to reduce any complexity in the process. It would need to reduce reliance on rules to be specified later and also ameliorate provisions that contravene other legislations.

Merger and Amalgamation process under Companies Act, 2013
The Companies Act, 2013 (2013 Act) has seen the light of day and replaced the 1956 Act with some sweeping changes including those in relation to mergers and acquisitions (M&A).

The new Act has been lauded by corporate organizations for its business-friendly corporate regulations, enhanced disclosure norms and providing protection to investors and minorities, among other factors, thereby making M&A smooth and efficient. Its recognition of interse shareholder rights takes the law one step forward to an investor-friendly regime. The 2013 Act seeks to simplify the overall process of acquisitions, mergers and restructuring, facilitate domestic and cross-border mergers and acquisitions, and thereby, make Indian firms relatively more attractive to PE investors.

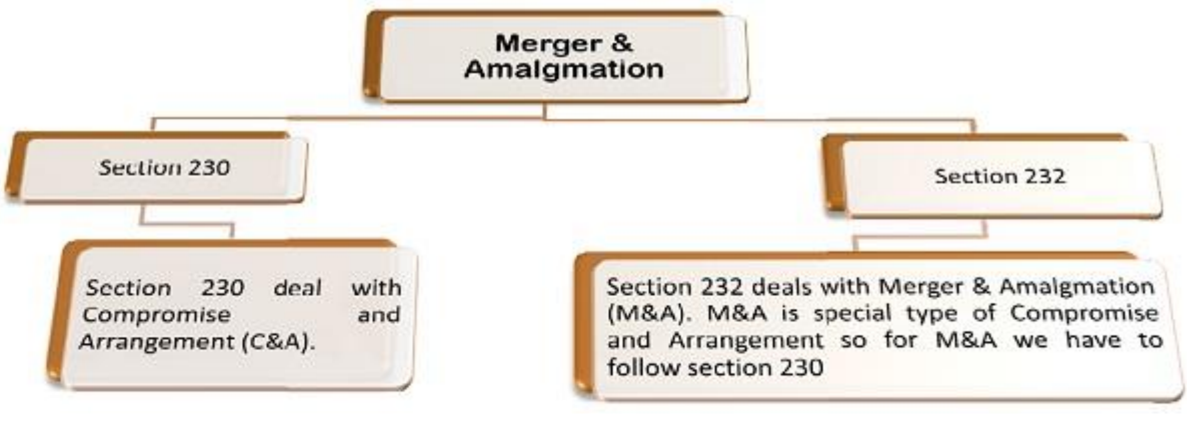
The term 'merger' is not defined under the Companies Act, 1956 ("CA 1956"), and under Income Tax Act, 1961 ("ITA"). However, the Companies Act, 2013 ("CA 2013") without strictly defining the term explains the concept. A 'merger' is a combination of two or more entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but organization of such entity into one business.

On 7th November, 2016 Central Government issued a notification for enforcement of section 230-233, 235-240, 270-288 etc w.e.f. 15th December, 2016. But still rules were not available till date for CAA.

MCA vide notification dated 14th Dec, 2016 has issued rules i.e. The Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. These rules will be effective from 15th December, 2016. Consequently, w.e.f. 15.12.2016 all the matters relating to Compromises, Arrangements, and Amalgamations (hereafter read as "CAA") will be dealt as per provisions of Companies Act, 2013 and The Companies (Compromises, Arrangements, and Amalgamations) Rules, 2016.

Where a compromise or arrangement is proposed for the purposes of or in connection with scheme for the reconstruction of any company or companies, or for the amalgamation of any two or more companies, the petition shall pray for appropriate orders and directions under section 230 read with section 232 of the Act.

Section relating to Merger & Amalgamation Section 230 & 232.



In this section COMPROMISE & ARRANGEMENT (C&A) will be read in relation to Merger & Amalgamation only.

In Case of application filing u/s 230 for Compromise & Arrangement in relation to reconstruction of the Company or companies involving merger or the amalgamation of any two or more companies should specify the purpose of the scheme.

Who can file the application for Merger & Amalgamation propose: Section 230(1)
[1]An application for Merger & Amalgamation can be file with Tribunal (NCLT). Both the transferor and the transferee company shall make an application in the form of petition to the Tribunal under section 230-232 of the Companies Act, 2013 for the puspose of sanctioning the scheme of amalgamation.

Joint Application: Rule 3(2)
Where more than one company is involved in a scheme, such application may, at the discretion of such companies, be filed as a joint-application.

[2]However, where the registered office of the Companies are in different states, there will be two Tribunals having the jurisdiction over those, companies, hence separate petition will have to be filed.

Process
It must be ensure that the companies under amalgamation should have the power in the object clause of their Memorandum of Association to undergo amalgamation though the absence may not be an impediment, but this will make matters smooth.

A draft scheme of amalgamation shall be prepared for getting it approved in Board meeting of each company.

1. Format of Application
Application to the tribunal for Merger & Amalgamation will be submitted in form no. NCLT-1 along with following documents: Rule 3(1)

a) A notice of admission in Form No. NCLT-2

b) An affidavit in form no. NCLT-6

c) A copy of Scheme of C&A (Merger & Amalgmation)

d) A disclosure in form of affidavit including following points Section 230(2)

- All material facts relating to the company, such as

    i. the latest financial position of the company,

    ii. the latest auditor's report on the accounts of the company and

    iii. the pendency of any investigation or proceedings against the company

- Reduction of share capital of the company, if any, included in the compromise or arrangement

e) Any scheme of [3]Corporate Debt Restructuring consented to by not less than seventy five per cent. of the secured creditors in value, including

i. A Creditor's Responsibility statement in the form No. CAA-1.

ii. safeguards for the protection of other secured and unsecured creditors;

iii. report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;

iv. where the company proposes to adopt the corporate debt restructuring guidelines specified by the Reserve Bank of India, a statement to that effect; and

v. a valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

f) The applicant shall also disclose to the Tribunal in the application, the basis on which each class of members or creditors has been identified for the purposes of approval of the scheme.

2. Calling of Meeting by Tribunal:
Upon hearing of the application Tribunal shall, unless it thinks fit for any reason to dismiss the application, give such directions / order as it may think necessary in respect meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as prescribed in rule 5 of CAA Rules, 2016 as follow:

i. Fixing the time and place of the meeting or meetings;

ii. Appointing a Chairperson and scrutinizer for the meeting or meetings to be held, as the case may be and fixing the terms of his appointment including remuneration;

iii. Fixing the quorum and the procedure to be followed at the meeting or meetings, including voting in person or by proxy or by postal ballot or by voting through electronic means;

iv. Determining the values of the creditors or the members, or the creditors or members of any class, as the case may be, whose meetings have to be held;

v. Notice to be given of the meeting or meetings and the advertisement of such notice.

vi. Notice to be given to sectoral regulators or authorities as required under sub-section (5) of section 230;

vii. The time within which the chairperson of the meeting is required to report the result of the meeting to the Tribunal; and

viii. Such other matters as the Tribunal may deem necessary.

3. Notice of Meeting:

The Notice of the meeting pursuant to the order of tribunal to be give in Form No. CAA-2. Rule 6

Person entitled to receive the notice

The notice shall be sent individually to each of the Creditors or Members and the debenture-holders at the address registered with the company. Section 230(3)

Person authorized to send the notice:

- Chairman of the Company, or
- If tribunal so direct- by the Company or its liquidator or by any other person

Modes of Sending of notice:

- By [4]Registered post, or by Speed post, orby courier, or
- By e-mail, or by hand delivery, or by any other mode as directed by the tribunal

Documents to be send along with notice:

The notice of meeting send with (i) Copy of Scheme of C&A and (ii) Following below mentioned details of C&A if not included in the said scheme:

a. Details of the order of the Tribunal directing the calling, convening and conducting of the meeting:-

- Date of the Order;
- Date, time and venue of the meeting.

b. Details of the company including:

- Corporate Identification Number (CIN) or Global Location Number (GLN) of the company;
- Permanent Account Number (PAN);
- Name of the company;
- Date of incorporation;
- Type of the company (whether public or private or one person company);
- Registered office address and e-mail address;
- Summary of main object as per the memorandum of association; and main business carried on by the company;
- Details of change of name, registered office and objects of the company during the last five years;
- Name of the stock exchange (s) where securities of the company are listed, if applicable;
- Details of the capital structure of the company including authorised, issued, subscribed and paid up share capital; and
- Names of the promoters and directors along with their addresses.

c. Relationship in case of Combined Application:

if the scheme of compromise or arrangement relates to more than one company, then the fact and details of any relationship subsisting between such companies who are parties to such scheme of compromise or arrangement, including holding, subsidiary or of associate companies.

d. Disclosure about effect of M&A on material [5]interests of directors, Key Managerial Personnel (KMP) and debenture trustee

e. Details of Board Meeting:

- The date of the board meeting at which the scheme was approved by the board of directors
- The name of the directors who voted in favour of the resolution,
- The name of the directors who voted against the resolution and
- The name of the directors who did not vote or participate on such resolution

f. Explanatory Statement disclosing details of the scheme of compromise or arrangement including:

- Parties involved in such compromise or arrangement;
- Appointed date, effective date, share exchange ratio (if applicable) and other considerations, if any;
- Summary of valuation report (if applicable) including basis of valuation and fairness opinion of the registered valuer, if any, and the declaration that the valuation report is available for inspection at the registered office of the company;
- Details of capital or debt restructuring, if any;
- Rationale for the compromise or arrangement;
- Benefits of the compromise or arrangement as perceived by the Board of directors to the company, members, creditors and others (as applicable);
- Amount due to unsecured creditors.

g. Disclosure about the effect of the Merger & Amalgamation (C&A) on: Section 230(3)

- Key Managerial Personnel;
- Directors;
- Promoters;
- Non-Promoter Members;
- Depositors;
- Creditors;
- Debenture holders;
- Deposit trustee and debenture trustee;
- Employees of the company:
- Share holders of the Company

h. A report adopted by the directors of the merging companies explaining effect of compromise on each class of shareholders, key managerial personnel, promoters and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties;

i. Below Mentioned Details:

Following below mentioned details

- Investigation or proceedings, if any, pending against the company under the Act.
- Details of approvals, sanctions or no-objection(s), if any, from regulatory or any other governmental authorities required, received or pending for the proposed scheme of compromise or arrangement

- A statement to the effect that the persons to whom the notice is sent may vote in the meeting either in person or by proxies, or where applicable, by voting through electronic means
- A copy of the [6]valuation report, if any Section 230(3)

j. Details of avaibility of documents:
Details of the availability of the following documents for obtaining extract from or for making or obtaining copies of or for inspection by the members and creditors, namely

- Latest audited financial statements of the company including consolidated financial statements;
- Copy of the order of Tribunal in pursuance of which the meeting is to be convened or has been dispensed with;
- copy of scheme of Merger & Amalgamation (C&A);
- Contracts or agreements material to the Merger & Amalgamation (C&A);
- The certificate issued by Auditor of the company to the effect that the accounting treatment, if any,
- Proposed in the scheme of Merger & Amalgamation (C&A) is in conformity with the Accounting Standards prescribed under Section 133 of the Companies Act, 2013; and
- Such other information or documents as the Board or Management believes necessary and relevant for making decision for or against the scheme;

k. Some Other documents:
Where an order has been made by the Tribunal under section 232(1), merging companies or the companies in respect of which a division is proposed, shall also be required to circulate the following:

- The draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging company;
- Confirmation that a copy of the draft scheme has been filed with the Registrar;
- The report of the expert with regard to valuation, if any;

Explanatory notes

[1] In the case of Kirloskar Electricals Co. Ltd., the Court held that various clauses of Section 394(1) of the Companies Act suggest that both the transferor and the transfer company shall make an application to the Court and under section 391-394 of the Companies Act, 1956 for sanction of the scheme of Compromise or arrangement involving amalgamation of the Companies.

[2] In the case of Mohan Exports Ltd. V/s Tarun Overseas Pvt. Ltd., it was held that if both the Companies are under the jurisdiction of the same High Court, Joint petition may be made.

[3] Scheme of Corporate Debt restructuring as referred in section 230(2)(c) means “a scheme that restructures or varies the debt obligation of a company toward its creditors”.

[4] It is hereby clarified that the service of notice of meeting shall be deemed to have been effected in case of delivery by post, at the expiration of forty eight hours after the letter containing the same is posted

[5]Explanation – For the purposes of these rules it is clarified that-

(a) the term 'interest' extends beyond an interest in the shares of the company, and is with reference to the proposed scheme of compromise or arrangement.

(b) the valuation report shall be made by a registered valuer, and till the registration of persons as valuers is prescribed under section 247 of the Act, the valuation report shall be made by an independent merchant banker who is registered with the Securities and Exchange Board or an independent chartered accountant in practice having a minimum experience of ten years.

[6] the valuation report shall be made by a registered valuer, and till the registration of persons as valuers is prescribed under section 247 of the Act, the valuation report shall be made by an independent merchant banker who is registered with the Securities and Exchange Board or an independent chartered accountant in practice having a minimum experience of ten years.

Merger of Financial Institutions and Compulsory Merger

Banking companies play a leading role in stimulating and stabilizing the growth of an economy of a country, hence failure of banks have a great impact than the failure of firms in other sectors. As a result, banks are subject to more intense regulations than in any other sectors and the state is more pro-active in intervening to prevent bank failures. According to Fidler, when a customer deposits money in a bank account, he does not deposit the money; but he lends it to the banker. The relationship between the banker and customer is therefore the contractual relationship of debtor and creditor.

A bank regulation can be said to have a single goal; the prevention of bank failure. Banking business is regulated in many ways. Regulation through licensing, prescribing the competency of management, determining capital adequacy, restrictions on the nature of business and various other matters which aim to ensure that the interest of the depositors are protected and banks will ensure financial stability. Despite such regulatory control there are clear evidences of bank failure in India.

Mergers and Acquisitions are a significant process through which financial service industries accomplish the preferred economic growth. Motive for merger in the banking sector is for cost reduction, rationalization of branch networks, investment in new technologies and process, income increase, risk reduction, diversification, and strengthening of the strategic position.

In India, originally the Banking Regulation Act, 1949 did not contain any provisions for mergers and acquisition among banking companies. Banking laws (Amendment) Act, 1950 for the first time recognized the right to voluntary amalgamation of banking companies by inserting Section 44A to the Banking Regulation Act, 1949. It conferred power to the Reserve Bank of India to sanction the scheme of amalgamation between banking companies. Mergers and acquisitions governing the banks are not uniform in nature.

In some cases, RBI needs to sanction scheme, whereas in the compulsory merger under Section 45 of Banking Regulations Act, 1949, RBI needs to prepare the scheme and the same will be presented before the Central Government for its sanction. Amalgamations of two or more corporations either in the public interest or in order to secure proper management of any of the corporation is recognized by our Constitution. As far as the merger of private banking Companies in India, the Banking Regulation Act plays an important role and it protects the rights guaranteed under Art.14 and 19 of the constitution. Constitutional validity of the Banking Regulation Act was challenged in Shivkumar Tulsian and others v. Union of India wherein the Bombay High court held that section 45 is in conformity with the constitutional provisions of Art 19 and 14.

Until 1950 the amalgamation of banking companies were governed by the Companies Act, 1913. Section 44A of the Banking Regulation Act lays down the procedure for the amalgamation of private sector banking companies. The scheme containing the terms of amalgamation is to be approved by a majority in number representing two thirds in value of the shareholders in the general meeting. A dissenting shareholder is entitled to receive the value of his shares as may be determined by the Reserve Bank of India. The Reserve bank has to sanction the scheme after the shareholders' approval. On such sanction, the assets and liabilities of the bank are transferred to the transferee company.

The major distinction between Merger under the Companies Act and Banking Regulation Act is that the scheme of amalgamation of companies under the companies Act has to be sanctioned by the tribunal. Whereas Under the Banking Regulation Act, voluntary amalgamation of bank mergers has to be approved only by the Reserve bank of India and it is the sole authority in all matters relating to the banking companies. As stated by the Supreme Court in Joseph Kuruvila Vellikunnel v. Reserve Bank of India, that the banking companies cannot be compared with the ordinary companies as in a banking company, depositor's interest is paramount and in India RBI is an expert body in determining and protecting the best interest of banking companies.

BANK MERGERS: REGULATORY REGIME IN INDIA

Regulatory frame work for Bank mergers in India

The commercial banks as a group form the preponderant part of the organized banking system and fall into four classes based on their method of establishment and pattern of ownership. These are banks in the public sector, banks in the private sector, foreign banks and regional rural banks.

The mergers and acquisitions regulations in the Indian Banking sector can be broadly placed as per the nature of the entities involved and of the mergers, into several categories, viz.,

(a) Voluntary amalgamation between private sector banks
(b) Compulsory amalgamation of a private sector banks
(c) Acquisition of banking companies by the central government in Part IIC of the Banking Regulation Act,1949
(d) Merger between public sector banks

(e) Merger of a Non –Banking Financial Company (NBFC) with a private sector bank
(f) Merger among co-operative banks
(g) Merger between Regional Rural Banks
(h) Mergers of State Bank of India and its associates.

There are four categories restructuring of Banking Companies under the Banking Regulation Act,1949

(a) Voluntary Amalgamation
(b) Compulsory Amalgamation
(c) scheme of arrangement between banking company and its creditors
(d) Acquisition of banking companies by the Central Government under Part-IIC of the Banking Regulation Act,1949.

Jurisprudential basis for the recognition of special provisions for the restructuring of banking Companies under the Banking Regulation Act,1949:
Prior to 1960, the amalgamation of banks could be only in terms of section 44A of the Banking Regulation Act, 1949, on a voluntary basis. In order to accelerate the process of integration, additional statutory and regulatory powers for the reconstruction or compulsory amalgamation of banks were inserted by the amendment of the Act, 1960. Banking Companies (Second) Amendment Bill,1960 proposed for the introduction of Section 45 and Section 44A (7) to the Banking Regulation Act,1949.

Voluntary Amalgamation of Banking Companies:
Merger between two private sector banking companies is governed by Section 44A of the Banking Regulation Act, 1949. In this regard the Madras High court in Bank of Madura, Shareholders Welfare Association v Governor, Reserve Bank of India and Others, has held that the provisions of the Banking Regulation Act constitute a complete code in themselves on the amalgamation of banking companies. S. 44A of the Banking Regulation Act, 1949 provides that no banking company shall be amalgamated with another banking company, notwithstanding anything contained in any law, unless the scheme for amalgamation has been placed in draft before the shareholders of both companies.

Approval of the scheme is required by means of a resolution of two-thirds of the majority of the shareholders present in either company , in a meeting specifically called for the purpose of amalgamation. Once this scheme has been approved in due compliance with the requirements under Section 44A (2), it should be submitted to the Reserve Bank of India for sanction. Once sanctioned by the Reserve Bank, it is binding on all the shareholders and the companies.

However, Section 44 A (3) protects the rights of the dissenting shareholders who have either voted against the scheme or have given notice of such dissent in writing. Reserve Bank of India determines the value of shares to be paid to dissenting shareholders. Section 44 A of the Banking Regulation Act, 1949 shows that it departs from the provisions of the Companies Act, 1956 in primarily two aspects, namely

(1) the High court is not given the power to grant its approval to the scheme for merger of banking companies instead the Reserve Bank , which is the central bank of the country and supreme regulatory authority in banking supervision and

(2) The Reserve Bank of India is also empowered to determine the market value of shares of the shareholders who has voted against the scheme of amalgamation . The banking Regulation Act enables the dissenting shareholder to obtain from the banking company concerned the market value of his shares as determined by the Reserve Bank of India under S. 44A (3).

In Bank of Madura Shareholders Welfare Association v. Governor, Reserve Bank of India, it was held that if the shareholders were aggrieved that the market value of shares of both the companies had not been determined properly, it was always open to it to get the market value evaluated by the Reserve Bank of India and that the court would not go into the question whether the share exchange ratio adopted in the scheme was fair or not.

Scope of S. 44-A of the Banking Regulation Act, 1949:
The provision of Section 44A of the Banking Regulation Act, 1949 comes into effect only if the transferor and transferee are both banking companies within the meaning of The Banking Regulation Act, 1949. Since Nationalized banks, Co-operative banks, Regional Rural Banks and State Banks of India are governed by the separate statutes, the merger provisions of the Banking Regulation Act and the Companies Act, 1956 is not applicable to it. IndusInd Enterprises and Finance Ltd v. IndusInd Bank Ltd., the issue was whether prior permission of Reserve Bank of India is necessary for amalgamation of a scheme under the Banking Regulation Act, 1949. The case concerned with the merger between a banking company and a non –banking Company. Bombay high court held that no prior sanction of RBI is necessary for the amalgamation of non-banking finance company with banking company.

Share valuation during merger under Section 44A:
The difficulty in arriving at share valuation was discussed in detail in In Re: ICICI Ltd, where a scheme was prepared for the amalgamation between ICICI Capital Services Ltd. and ICICI Personal Financial Services Ltd. with ICICI Bank Ltd. The petitioner and two other companies are the transferor companies and they are to be amalgamated with the ICICI Bank Ltd., the transferee company.

Petitioners two main objection were.

1) The approval of the RBI was not sought for a scheme of amalgamation as the transferee was a banking company

2) Valuation of shares was not arrived at properly. To the first question court held that the objection has no substance, in as much as, the provisions of section 44A come into play only in case the transferee and transferor, both the companies are Banking Companies.

In the said case, though the transferee company is a banking company, none of the transferor companies are banking companies. The objection did not sustain. While deciding that case, the court referred Piramal Spg & Wvg. Mills Ltd, and cited what was there as that the valuation of shares is a technical matter which requires considerable skill and expertise.

There are bound to be differences of opinion as to what the correct value of the shares of any given company is, simply because it is possible to value the shares in a manner different from the one which has been adopted in a given case, it cannot be said that the valuation which has been agreed upon is unfair.

Court thus held that what is important is that all shareholders of both companies have unanimously accepted the valuation which has been arrived at by the auditors of the transferor and transferee companies, under these circumstances, the application cannot be rejected on the ground that the valuation of shares is unfair to the shareholders of the transferor-company.

PROCEDURE OF COMPULSORY AMALGAMATION OF PRIVATE SECTOR BANKS:

Under section 45 of the Banking Regulation Act, RBI has the power to force the merger of a weaker bank with a stronger Bank. The scheme is in public interest or in the interest of the depositors of the distress bank or to secure proper management of a banking company, or in the interest of the banking system. In case of a banking company in financial distress, which has been placed under the order of moratorium, under sec45 (2) of the Act, on an application made by the Reserve bank to the central government, the Reserve bank can, for the foregoing reasons, frame a scheme of amalgamation for transferring the assets and liabilities of such distressed bank to a much better and stronger Bank.

Such a scheme framed by the RBI is required to be sent to the banking companies concerned, for their suggestions or objections, including those from the depositors, shareholders and others. After considering the same, RBI sends the final scheme of amalgamation to the central government for sanction and notification in the official gazette. The notification issued for compulsory amalgamation also under section 45 of the Act is also required to be placed before the two houses of parliament. Most of the amalgamations of the private sector banks in the post-nationalization era were induced by the Reserve Bank in the larger public interest, under Section 45 of the Act.

In all these cases, the weak or financially distressed banks were amalgamated with the healthy public sector banks. The over-riding principles governing the consideration of the amalgamation proposals were:

(a) protection of the depositors' interest;
(b) expeditious resolution; and
(c) avoidance of regulatory forbearance.

Judicial Review under Section 45:

Scope of Judicial Review under section 45 of the banking Regulation was discussed in Davis Kuriape v. Union of India. wherein Court held that when a scheme is framed under Section 45 for amalgamation, judicial review thereof is permissible only to a very narrow extent. Particularly when a dispute or difference arising with regard to the equivalence of experience has been decided by the Reserve Bank in exercise of its powers under the second proviso to Section 45(5)(i), the High Court in writ jurisdiction cannot sit in appeal over such Judgment. It can only interfere in extreme cases of arbitrariness or unreasonableness. As to the criteria adopted for judging the equivalence of experience in two different banks which are being amalgamated, the Reserve Bank being an expert body in banking operations would the best judge. The High Court is neither equipped, nor capable of handling such a delicate task which requires expertise and deep knowledge of banking operations.

Acquisition of Banking Companies by the Central Government under Part IIC of the Banking Regulation Act, 1949:
Part-II C of the Banking Regulation Act, 1949 deal with the acquisition of the undertakings of banking companies by the Central government. Part IIC of the Banking Regulation Act was added at a time, when government decided to acquire the control of privately operated banking companies. It was in the year 1968 the Banking companies (Acquisition and transfer of undertaking) ordinance was issued and which became the Bank Nationalization Act in the year 1969.

It is to be noted that for the government to exercise the power to acquire the private banking companies Part -IIC was added. Section 36AE does not confer suo-moto power to the Central government to acquire the business of a banking company. A report by RBI is essential and RBI is entitled to submit the report only if the banking company has failed to conform to its directions under section 21 or under Section 35A or if it was managed in a manner detrimental to the interest of its depositors.

Restrictions on Acquisition of shares or voting rights in Banking Companies:
Banking Laws (Amendment) Act, 2012 inserted section 12B to the Banking Regulation Act, 1949. It imposes cap on acquisition of shares or voting rights in the banking companies. If an individual or company acquires more than five percentage of the total paid up share capital or voting rights, without the permission of the central government, it would be detrimental to the interest of the banking company and in turn prejudice the public interest. Section 3 (2D) of the Banking companies (Acquisition and Transfer of Undertakings) Act, 1970, states that the ―shares of every corresponding new bank not held by central government shall be freely transferable. A proviso to the section 3(2D) states that if at any time an individual or company shall not hold more than twenty percent of the total paid up share capital of the company.

Amalgamation of NBFCs with Banking Companies:
Chapter –III B of the Reserve Bank of India Act, 1934 confers powers to the Reserve bank to regulate the Non- banking companies and financial institution ‗s deposit taking business. In addition to the same, there are number of guidelines issued by RBI to regulate the working of Non-Banking Financial Companies. The latest among the same is the Revised Regulatory Guidelines for NBFCs issued in Nov 10, 2014. In India, merger between banks and non-banking companies are sanctioned by High court under Ss. 232-234 of the Companies Act, 2013. There is no provision in the Banking Regulation Act that states that the banks need to get prior approval of RBI before approaching the court.

Reserve bank of India has issued guide line and directions to be followed by banking companies in case of merger or acquisition between a bank and non-banking financial institutions. RBI direction on Acquisition of NBFCs states that Prior written approval of the Reserve Bank would also be required before approaching the Court or Tribunal under Section 391-394 of the Companies Act, 1956 or Section 230-233 of Companies Act, 2013 seeking order for mergers or amalgamations with other companies or NBFCs.

Amalgamation of Public sector Banks:
In the case of public sector banks, i.e., nationalized banks, the statutory frame work differs wherein the provisions of the Banking Regulation Act do not apply. The amalgamation of public sector bank is governed by section 9(1)(c) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 & 1980, which is known as the Bank Nationalization Act. It authorizes the central government to prepare a scheme of amalgamation in consultation with RBI for the transfer of one bank to another corresponding new bank. The scheme framed under there will be placed before both the houses of parliament for approval.

Merger of co-operative banks:
Law and Procedure: Most of the States in India have enacted Co-operative Societies Act and it deals with provisions governing merger. Registrar of the co-operative societies supervises the merger scheme of co-operative banks. Even though mergers/amalgamations of Co-operative banks come within the purview of concerned State Government, prior approval from the Reserve Bank is required for obtaining No Objection Certificate. Reserve bank of India has issued two guidelines on the issue of merger to the Co-operative banks in the year 2005 and 2009.

RBI ‘s 2005 guideline allow co-operative banks to merge with any other co-operative banks or banks registered under the Multi-state co-operative societies Act. It also states the procedures of such merger as An application for merger giving the proposed scheme will have to be submitted by the banks concerned to the Registrar of Cooperative Societies/Central Registrar of Cooperative Societies. The acquirer bank will also forward a copy of the scheme to the Reserve Bank along with the draft scheme, valuation report and other information relevant for consideration of the scheme of merger. the Reserve Bank issued another set of guidelines in January 2009 for merger/acquisition of UCBs having negative net worth as on End-March 2007.

According to the new guidelines, the Reserve Bank would also consider scheme of amalgamation that provides for

(i) payment to the depositors under section 16(2) of the Deposit Insurance and Credit Guarantee Corporation Act, 1961;
(ii) financial contribution by the transferee bank; and
(iii) sacrifice by large depositors. The process of merger/amalgamation requires the acquirer bank to submit the proposal along with some specified information to Registrar of Cooperative Societies/Central Registrar of Cooperative Societies and the Reserve Bank.

RBI’S POLICY ON MERGER OF BANKING COMPANIES
RBI as an expert body in regulating banks in India has been recognized by the courts through various judgments. In Peerless General Finance and Investment co. Ltd v. R.B.I. ,the Supreme court held that the Reserve Bank plays an important role in the economy and financial affairs of the country and its main role is to regulate the banking industry .The supervisory functions of the RBI have helped a great deal in improving the standard of banking in India to develop on sound lines and to improve the methods of their operation. As mentioned before, the Banking Regulation Act, 1949 provide for two types of mergers Forced and Voluntary mergers. The Forced mergers are initiated by the RBI. The main objective is to protect the interest of the depositors of the weak bank.

When a bank has shown symptoms of sickness such as huge NPAs and substantial erosion of net worth, RBI has intervened and merged the weak bank with the strong bank.

The Procedures of both voluntary and compulsory mergers under the Banking Regulation Act is applicable only to the Private Sector Banking Companies. Merger of Public Sector banks viz., the Nationalized Banks and State Bank of India and its associates are being governed by the separate statutes. Consolidation of Regional Rural banks are governed by the Regional Rural Banks Act, 1976.

Role of RBI in Compulsory Merger of Private Sector Banking Companies:
Under S. 45 of the Banking Regulation Act, 1949, Reserve Bank of India is empowered to apply to the central Government for suspension of business by a banking company and to prepare a scheme of reconstruction or amalgamation. It provides for a compulsory amalgamation of a banking company with any other banking company, without the consent of creditors or members. A moratorium has to be declared by the central government prior to a scheme prepared by the RBI. During the period of Moratorium RBI for the interest of the various stakeholders and to secure proper management of the banking company may prepare a scheme of amalgamation or merger.

The scheme prepared by the RBI shall be sent in draft to the banking company and also to the transferee bank and any other banking company concerned in the amalgamation. It further provides that the scheme so finalized by the Reserve Bank of India should be filed before the Central Government which may sanction the scheme with or without modifications.

Jurisdiction of High Court in Bank Mergers:
An interesting conflict arose before the High Court of Allahabad671 in this respect where the petitioner challenged an order of moratorium passed by the Central Government under section 45(2) of the Banking Regulation Act,1949, and a scheme prepared under Section 45(4) by RBI , on the grounds that there had previously been a High Court order under Section 153 of the Companies Act which sanctioned an arrangement by the shareholders and creditors of the bank for the continuance of the bank and satisfaction of the liabilities.

The Contention of the appellant was that Section 45 cannot operate to nullify the orders passed by the high court under the jurisdiction conferred on it by the Companies Act. The court ruled that such reading went against the wording ofs.45 which expressly stated that it operated notwithstanding all other laws, and dismissed the appeal. Jurisdiction of the High Court and the power of judicial review with regard to RBI 's decision on schemes of amalgamation are severely limited in many aspects. The maintenance of a distinction between the jurisdiction of the High court and RBI under Banking Regulation Act, 1949 was clarified by the Supreme Court in the decision of Himalayan Bank Ltd v. Roshan Brothers .

In this case it was held that a petition presented to the High court by a bank currently under a sanctioned scheme of amalgamation under Ss.45M and 45B of the Banking Regulation Act, could be entertained, as the High court retained jurisdiction to pass orders under section 392 read with section 391 of the Companies Act. In such cases, the court pointed out that the scheme of amalgamation was not a substitute or an alternative mode of liquidation, but rather was an alternative to liquidation itself.

Bank Mergers:

CCI v. RBI: Reserve Bank of India sought an exemption from CCI scrutiny of bank mergers through the Banking Laws (Amendment) Bill, 2011. Section 2A of the Bill provided that ―Notwithstanding anything contrary contained in Section 2 of the Banking Regulation Act, 1949, nothing contained in Competition Act, 2002, shall apply to any banking company, the State Bank of India, any subsidiary bank, any corresponding new bank or any regional rural bank or cooperative bank or multi-state cooperative bank in respect of the matters relating to amalgamation, merger, reconstruction, transfer, reconstitution or acquisition under respective Acts. Through this amendment, though the Reserve Bank of India (RBI) tried to remove the scrutiny of competition commission of India over bank mergers it could not succeed. Ministry of corporate affairs issued a notification on 8th January 2013, by which Central Government exempted mergers under section 45(forced mergers) of the Banking regulation Act, 1949 from the applicability of section 5 and 6 of the Competition Act, 2002 in public interest for a period of five years, but the voluntary mergers among the banking sector requires the prior approval of CCI.

CONCLUSION

The basic reason for the regulation of banking company is that it is an institution wielding enormous responsibilities to the depositor‘s money and to mitigate the risk of failure of a banking institution is the responsibility of the regulators. Bank mergers are no exception to it. Competition commission is responsible for preventing abuse of dominance position of any company or enterprise in the market so as to avoid the practices having adverse effect on the competition.

Competition commission‘s role is not confined to any specific sector of business or service in India, but it is the regulator of all kinds of services and business where it is likely to have an effect on free competition in the market. Thus, it is appropriate to confer power to the CCI to regulate the bank mergers.

CCI is concerned about the anti-competitive agreements and abuse of dominant position in the market. It can look into all types of business activities. Its power is not confined to any specific sector. However, considering the numerous types of banking companies in India and RBI, being the regulator of bank merger, it is suitable to appoint a committee of persons under the chairmanship of RBI governor to study the competition law aspects of bank mergers.

The usual method of assessing the completion aspects of other industries should not be applied to banking companies. Public interest and depositor ‘s interest must be given an overriding effect over the market requirement of competition in bank mergers. Further, it is appropriate to amend the existing provisions of the bank mergers under the Banking Regulation Act,1949, so as to include the specific powers of CCI in respect of bank mergers of different nature of banking companies .

Though, there are difference in the nature of banking companies , total number of banks are in each sector is few, hence the consolidation in banking business should be viewed very seriously, as it may shrink the market for banking and the interest of the customers of banking companies will be affected.

Financial and Legal Due Diligence

For a layman, the term 'Due Diligence' means the reasonable verifications and precautions taken to identify or prevent foreseeable risks. It is the process of evaluating a business situation diligently from various aspects before arriving at a decision.

In the context of an M&A transaction, Due Diligence provides the buyer with reliable and complete background information on proposed deal and also helps in uncovering potential liabilities and discrepancies and thus enables the buyer to take an informed decision. There are various forms of Due Diligence depending upon the area/scope of coverage like

1. Financial Due Diligence
2. Legal Due Diligence
3. Commercial Due Diligence
4. Tax Due Diligence.

Other diligences may be performed in areas such as IT and human resources. It should be noted that there are no clear boundaries between these categories.

One or more of the above areas may not be relevant to all Due Diligence engagements and a bespoke scope will be required to focus on the issues of each unique transaction.

Why Due Diligence is important in M&A:

• To investigate into the affairs of a business as a prudent business-person
• To confirm all material facts related to the business
• To access the risks and opportunities of a proposed transaction
• To reduce the risk of post-transaction unpleasant surprises
• To confirm that the business is what it appears
• To identify areas that influence valuation of the deal
• To identify potential deal breakers in the Target company and avoid a bad business transaction

Planning effective Due Diligence:

The first step of any Due Diligence assignment should be to discuss the scope of the engagement with the client to do the following:

• Understand the proposed transaction and the degree of access expected
• Understand what benefits are expected to arise from the Due Diligence process
• Identify client concerns and implement strategy to counter these
• Determine the overall timelines for the process and delivery of the Due Diligence report.

Once agreed, the scope of the engagement will allow advisors to deliver a report containing information pertinent to the acquirer, which will act as a meaningful decision-making tool throughout the transaction.

Types of Due Diligence:

I. Business Due Diligence: This mainly includes the following types

a. Operational Due Diligence

Aims at the assessment of the functional operation of the Target company. Consideration of non-financial matters of a Target business, which may include assessment of systems and processes, review of the incumbent management team, staffing levels and other HR activities, or insurance arrangements and risk assessment.

b. Technical Due Diligence

Involves review & diligence of intangible assets like Patents, Copyrights, Designs, Trademarks and Brands. It also includes assessing the Target company's performance on current level of technology and further scope of improvement in this regard.

Some of the primary reasons for conducting Business Due Diligence include:

• Assess the opportunities available to the Target company for margin expansion.
• Validate the vendor assumed operational improvements in projections.
• To evaluate the competitive landscape and the technological trends along the industry's value chain which are key parameters to understand the business of the Target company.

Key Focus Areas of Business Due Diligence:

♦ Technology/Intellectual Property
The buyer will be interested in the extent and quality of the Target company's technology and intellectual property. Key questions will revolve around the following:

- What domestic and foreign patents does the Target company have?
- Has the Target company taken appropriate steps to protect its intellectual property
- What registered and common law trademarks and service marks does the Target company have?
- What copyrighted products and materials are used, controlled, or owned by the Target company?
- Is the Target company infringing on (or has the Target company infringed on) the intellectual property rights of any third party, and are any third parties infringing on (or have third parties infringed on) the Target company's intellectual property rights?
- Is the Target company involved in any intellectual property litigation or other disputes?
- What technology in-licenses does the Target company have and how critical are they to the Target company's business?
- Has the Target company granted any exclusive technology licenses to third parties?
- Are there any other liens or encumbrances on the Target company's intellectual property?

♦ **Sales & Marketing**
The buyer will want to fully understand the Target company's marketing strategies, customer base including the level of concentration of the largest customers as well as the sales pipeline. Topics of inquiry or concern will include the following :

• Who are the top customers and what is the share of revenues from each of them?
• What customer concentration issues/risks are there?
• Will there be any issues in retaining customers after the transaction?
• How & what seasonality in revenue and working capital requirements does the Target company typically experience?
• Does the Target company provide products, services, or technology the buyer doesn't have?
• What is the extent of sales returns and realization of sales?
• What revenue enhancements will occur after the transaction?

Basic checklist for conducting Business Due Diligence:
• Market Review including market mapping, market size, key players, industry value chain, value drivers, market potential, etc.
• With respect to each product line, understand the Target company's existing marketing strategy and any contemplated changes.
• Obtain a summary of significant new products, technologies or processes currently under development.
• Agreements related to the marketing of the Target company's products, franchise agreements, Target company sales forms or literature, including price lists, catalogs, purchase orders, etc
• Technology agreements, documents pertaining to proprietary technology developed / owned by the Target company including copyrights, patents filings, copy of all permits and licenses necessary to conduct Target company's business.
• Understand the status of the relationships with major suppliers and vendors, including a description of any supplier quality issues.

II. Legal Due Diligence:
Legal Due Diligence is the process of collecting, understanding and assessing all the legal risks associated during an M&A process.

Some of the primary reasons for conducting Legal Due Diligence include:
• To better understand the Target's legal arrangements and regulatory compliances
• Help in drafting the relevant M&A agreement
• Identify Impediments to closing the deal

Key Focus Areas include:

♦ **Material Contracts:**
One of the most time-consuming (but critical) components of a Due Diligence inquiry is the review of all material contracts and commitments of the Target company. Some of the categories of contracts that are important to review and understand include the following:

• Real estate leases/purchase agreements
• Review copies of all agreements affecting real property
• Review of all the insurance agreements

• Review of all guarantees and indemnities provided by the Target company

♦ **Financing Agreements:**
Review copies of all agreements evidencing borrowings by the Target company, whether secured or unsecured, documented or undocumented, including loan and credit agreements, mortgages, deeds of trust, letters of credit, indentures, promissory notes and other evidences of indebtedness, and any amendments, renewals, notices or waivers.

♦ **Litigation and Regulatory Matters:**
Review a documentation relating to and description of all pending, threatened or completed litigation, claims, suits and proceedings in which the Target company is, was or could be a defendant for the past five years, including the nature of the litigation, the amount involved and any opinion of counsel as to the probable outcome.

Basic checklist for conducting Legal Due Diligence:

• Memorandum and Articles of Associations and bye laws.
• Corporate regulations including special industry policies, practices and procedures
• Employment agreements
• Prospectus filed at the time of raising funds from public
• Copies of any lawsuits involving the Target company or the subsidiaries or any such decrees, orders or judgements of courts or governmental agencies
• Documents filed with ROC for registration of Charges or Immovable properties.
• Any settlements made in any of the litigations and if so documents relating thereto.
• Mortgages, financial or performance guaranties, indemnifications, equipment leases or other agreements evidencing outstanding loans which the Target company is a party or was a party within past three years.

III. Financial & Tax Due Diligence:

In an M&A transaction on the financial front, the buyer will be concerned with all of the Target company's historical financial statements as well as the reasonableness of the Target 's projections of its future performance. Financial Due Diligence will involve a review of historic data for the entire entity or possibly on specific projects, review of forecast performance and funding requirements.

Some of the primary reasons for conducting Financial Due Diligence are outlined below.:

• Financial Due Diligence is conducted to support deal decision making, negotiating, and eventually, post-announcement planning and execution
• Gain understanding of Financial position of Target company
• Arrive at the valuation of the Target company and to negotiate the purchase price

Key Focus Areas in Financial Due Diligence include:

♦ **Quality of Earnings:** Key questions will revolve around the following:

• Do the Target 's earnings closely approximate cash flows and if not, why?
• What do the Target company's annual and quarterly financial statements for the last five

years reveal about its financial performance and condition?
• Do the financial statements and related notes set forth all liabilities of the Target company, both current and contingent?
• What accounting treatment does the Target utilize in relation to its peers and what is the reasonable estimates?
• Are the Target company's projections for the future and underlying assumptions reasonable and believable?
• What normalized reinvestments (including working capital and net capex) will be necessary to every year to stimulate growth in operating income? How do the historical reinvestments look like?

♦ Financials & Operating Trends:
A focus on identifying and analyzing key operating and financial trends that are important to gauge the likely future earnings power of the Target.

General queries revolve around the following :

• What are the key factors which are driving the margin expansion or compression, rate of cash conversion and return on invested capital
• How does the Target company's operating cycle looks like over the last 5 years? What are the reasons for its improvement / decline. How does the Target company foresee them going forward?
• What is the condition of assets and liens thereon? Are the assets used productively?
• What is the impact of regulatory changes on the Target 's earnings potential.
• What is the Target 's performance with respect to KPI's and what is the quality and reasonableness of the benchmarks established?
• Are there any unusual revenue recognition issues for the Target company or the industry in which it operates?
• How is the business being impacted by related party transactions?

Basic checklist for conducting Financial Due Diligence:

• Audited financial statements for the historical period – linked to schedules, groupings and the trial balance along with the auditors' report and notes to the account.
• Analyzing Shareholding pattern of the Target company over the last 3 years
• Latest copy of CIBIL report and credit rating obtained by the Target company
• Details of changes made in accounting policies in the historical period and quantify the impact of the same on historical results.
• Management letters or special reports by auditors and any responses thereto for the last three financial years.

IV. Tax Due Diligence:
Tax Due Diligence typically involves reviewing the tax position adopted by the Target, adequacy of tax provisions made, status of tax holidays/ incentives availed of by the Target and unabsorbed tax losses and depreciation. Thus, a tax Due Diligence helps in understanding tax impact post the transaction and enables the stakeholders to make informed decisions.

Some of the primary reasons for conducting Tax Due Diligence are outlined below:

• Identification of inconsistencies in historical tax filings/ compliances, if any, and quantification of tax exposure thereof
• Analysis of tax positions taken by the Target and assessing their impact going forward
• Ascertain ongoing tax liabilities / litigations of the Target and what is the impact on deal's internal rate of return?
• Assessment of availability of tax attributes (tax holiday, unabsorbed losses, etc.) of the Target to the buyer
• Identifying underreported tax liabilities and ascertaining whether all tax liabilities are adequately provided for in the books
• Identifying if an alternate transaction structure is required where potential tax exposure in doing a transaction as per a given structure is significantly higher.

Key Focus Areas for conducting Tax Due Diligence include:

Some of the typical tax issues that come across in a Tax Due Diligence and have significant bearing on the transaction are as under:

♦ Recapture past losses upon change in shareholding:

Under the Indian tax regime, change in shareholding of a closely held Target company by more than 49% hampers its ability to carry forward unabsorbed tax losses (excluding depreciation) which were otherwise eligible to be carried forward for eight years. While conducting the Due Diligence, it needs to assess whether there has been any change in the shareholding of the Target in the past which has impaired its ability to carry forward the unabsorbed losses. Due Diligence also enables the buyer in ascertaining the balance/ unexpired period for which the tax losses can be carried forward by the buyer and in factoring the same in the valuation.

♦ Claim of tax holiday/incentives (Section 10AA, 80IA, etc.):

Under the Indian tax regime, tax holidays/incentives can be availed of for a specified period subject to the fulfilment of specified conditions. It is necessary to assess whether or not the conditions prescribed for availing of a tax holiday have been complied with by the Target company, the correctness of such a tax holiday claim and the unexpired period for which the tax holiday can be claimed by the buyer so that the buyer can factor the same in valuation.

♦ Recoverability of tax refunds/credits:
Tax Due Diligence helps the buyer in ascertaining the quality and recoverability of tax refunds/tax credits like MAT credit being claimed as eligible to be carried forward by the Target company.

♦ Transfer pricing (TP) documentation:
It needs to be assessed whether the TP documentation has been duly prepared and maintained by the Target company

Basic checklist for conducting Tax Due Diligence :
• Assessment status for the past three years with income tax returns and annexure• Historical tax filings & tax computations
• Copies of all notices, intimations, etc., received in the last three years

• For the current financial year (pending return of income),analyze details of all advance taxes paid (if any) including MAT
• Analyze indirect taxes such as Service Tax/ Value Added Tax/ Excise Duty/ Customs Duty
• Sample checks of withholding tax compliance

Due Diligence Documentation:

The final output of Due Diligence is presented in the form of a Due Diligence report. A good Due Diligence report should not only list the material issues identified in Due Diligence but also provide recommendations on how each issue could be dealt with.

Potential recommendations include requesting further information, conducting further Due Diligence, capturing the information into buyer's valuation of the Target, restructuring the transaction or purchase price payment, including in the transaction documents the completion of remedial action as a condition precedent to completion, a pre or post completion undertaking or covering off relevant risks with an indemnity.

Based on the findings of a Due Diligence exercise, the parties may negotiate the commercials of the M&A transaction, which could range from debt-like adjustment to the agreed consideration or taking appropriate indemnities from the seller or creating an escrow mechanism. At times, this may also necessitate structuring a deal to ensure that the interest of the buyer is protected. The acquirer will also seek legal protection.

Use of escrow accounts, indemnities and warranties are all common outcomes of the Due Diligence process. Typically, these will be included in any Share Purchase Agreement, with the vendor providing representations at the point of purchase. Should such provisions be refused by the vendor, then an acquirer may have to be prepared to walk away from the deal.

Some issues such as deficiencies in basic reporting cannot always be addressed pre-deal, despite the risk they may present to the acquirer. These can be dealt with using a post-deal plan whereby vendor and acquirer work together post acquisition to validate pre-deal assumptions, develop integration strategies and commence the delivery of short-term goals.

Conclusion:

Due Diligence should be regarded as an integral element of an M&A transaction. The Due Diligence process must be structured and co-ordinated in such a way that the information gathered enables the buyer to make an informed decision on whether to go through with the acquisition and whether to manage any post-acquisition issues that have been identified.

In addition, the Acquiring company's management and Due Diligence team, supported by external advisors if necessary, have to structure and focus their Due Diligence efforts on the buyer's objectives in order to verify that a purchase transaction can bring the desired benefits.

Module V: Equity & Debt Restructuring

Concept of Equity Restructuring

An equity restructuring is a transaction between a corporation and its shareholders that alters the fair value of the shares associated with an option or similar reward. Examples of the equity instruments that may be altered in a restructuring are a rights offering, stock split, or stock dividend.

The principal objective of equity restructuring is to provide adequate returns to shareholders and improve investors' confidence. Equity restructuring is also used as a strategic tool to minimise cost of capital, write-off losses and perhaps increase liquidity of stocks. Writing off losses or writing down assets against equity is a well-practiced strategy.

What has assumed more significance recently is the use of free cash by a profit-making firm. Free cash is the cash left with a firm after meeting profitable investments requirements. It is the responsibility of the managers to ensure that such free cash is not unproductively used. A natural choice could be distribution of such free cash to the shareholders by way of dividend or share buyback.

For example, the free cash flow per share of Apple has grown from USD 2.6 in 2010 to USD 12.6 in 2015. This is after significant share repurchase- the number of shares outstanding has dropped by 13% over the past five years for Apple. Apple has cash and marketable securities worth USD 233 billion out of total assets of around USD 300 billion in March 2016. Obviously there will be clamour for further distribution of free cash to the shareholders.

In India, TCS reported a free cash flow per share of INR 95.7 in March 2016 up from INR 26.4 in 2010. This is after paying INR 26000 crore as dividend in the past two years. TCS got its shares listed in 2004 and has never repurchased its shares. TCS shareholders may soon demand even higher dividend payments.

However, managers must ensure that they do not face underinvestment problem due to lack of cash in future. Therefore, an objective assessment of future capital expenditure is to be made before distributing free cash to the shareholders.

Prudent use of free cash is also a controversial issue for public sector enterprises in India. For example, Coal India had generated an operating cash flow of INR 197 billion in 2014-15 and spent only INR 49 billion in capital expenditure during the same period. Recently (May 2016) the Department of Investment and Public Asset Management (DIPAM), Ministry of Finance , Government of India has issued a guideline to all central public sector enterprises (CPSEs) on how to restructure equity and distribute free cash flows to shareholders.

The guideline attempts to bring together all equity restructuring options under a consolidated document. The guideline also categorically highlights its binding nature and requires specific approval of DIPAM for any exemption. A CPSE is an entity where Government of India and/or Government-controlled one or more body corporate have controlling interest.

Capital Restructuring Proposal for Central Public Sector Enterprises

Mode	Condition/Criteria
Cash Dividend	Minimum annual dividend of 30% of PAT (Profit after tax) or 5% of Net Worth, whichever is higher
Bonus Shares (Stock Dividend)	Compulsory issue of bonus shares if reserves and surplus is equal to or more than 10 times of paid up capital
Share Buyback	Option to buyback should be exercised if Net Worth is at least Rs. 2000 crore and Cash and Bank balance at least Rs. 1000 crore.
Stock Splits	Compulsory split if market price or book value of a share exceeds 50 times of its face value.

Source: Guidelines of Department of Investment and Public Asset Management (DIPAM), Govt. of India

Dividend Policy

The guideline of the Ministry of Finance did not require CPSEs to declare their dividend policy in the annual report. It simply mentioned the quantum of minimum dividend to be paid each year. The capital market regulator (SEBI) is contemplating mandatory disclosure of a company's dividend policy in an initial public offering (IPO) prospectus.

Regulators believe that shareholders demand transparency on dividend and have every right to know the expected use of cash, if the same is not distributed as dividend. SEBI has recently made it mandatory for top 500 listed companies to declare a dividend distribution policy to their shareholders. SEBI has also mentioned that if a company decides not to pay out dividend in a particular year, it must explain the reason and how the retained earnings will be used.

A stated dividend policy will remove speculation and help analysts estimate fair value of shares. The Financial Reporting Council of UK has brought out a report suggesting how companies can make dividend disclosures more relevant for investors.

The top ten CPSEs have distributed Rs. 2.5 trillion as dividend over the past ten years (up to 31 March 2015) and spent only Rs. 1.3 trillion for organic growth (net capital expenditure). The dividend paid is more than 5% of net worth of the CPSEs. Though the gross capital expenditure of the top ten CPSEs was Rs. 3.4 trillion, much of it was funded by depreciation. Dividend paid by these CPSEs over the past ten years is almost equal to the GDP of Odisha as on March 2015.

Therefore, even in the absence of such strong guidelines, the profitable CPSEs were paying handsome dividend to the shareholders, the principal beneficiary being Government of India. The top ten NIFTY companies (excluding CPSEs) paid Rs. 1.8 trillion as dividend during the same period- almost 30% lower than the CPSEs.

ONGC paid dividend of about Rs. 764 billion during the past ten years and spent Rs. 181 billion on capital projects. Coal India paid about Rs. 590 billion dividend in last ten years. The capital expenditure (net) incurred by the company during this period was abysmally low at only Rs. 2 billion. The third highest dividend paying CPSE was NTPC which distributed Rs. 418 billion as dividend and spent more than double of the amount (Rs. 863 billion) for capacity building. Government of India, as principal shareholder of the CPSEs, has directed all profitable CPSEs to follow the minimum dividend guideline.

Is it right for the major shareholder to 'compel' companies to pay any pre-announced dividend? Any prudent dividend policy would lay down circumstances when dividend will or will not be paid. The quantum should only be decided after evaluating the following factors:

(a) future expansion need;
(b) profit earned; and
(c) free cash flow.

However, in view of huge cash pile up and lack of clear expansion plans, the CPSEs would definitely face the heat of the shareholders for distribution of free cash. The situation equally applies to companies in the private sector.

Bonus Shares

The guideline directs that a CPSE should issue bonus shares if the retained earnings are more than 10 times paid up capital. The guideline further states that whenever the multiple (retained earnings/ paid up capital) exceeds 5, the concerned CPSE should evaluate the possibility of offering bonus shares. It is generally understood that bonus shares reward shareholders.

Typically, whenever retained earnings of a company become disproportionately higher and the concerned firm is unable to reward its shareholder by way of cash dividend, bonus shares prove useful. However, it is also to be noted that issue bonus shares act as poison pill and create permanent pressure on the treasury of a firm for future dividends. In that sense, bonus debenture could be a better choice.

Seven out of top ten CPSEs are required to issue bonus shares if one follows the diktat of the DIPAM guidelines. Most of these are from energy sector. It may be noted that five of these CPSEs had already issued bonus shares in the last ten years. If Government of India has plans to disinvest further its stake in these CPSEs, it is always prudent to have lower equity base. The blanket guideline on issue of bonus shares would bloat the paid up capital of many entities thereby making them unattractive to potential investors.

Share Buyback

Theory of corporate finance tells us that one of the motivations of share buyback is to distribute free cash to the shareholders so that the latter can use the funds profitably. There are examples of shareholders' pressure for buyback whenever any company holds too much of cash. But the real question is how much cash is too much? The DIPAM guidelines provide that any CPSE with a cash balance of more than Rs. 1000 crore should seriously consider share buyback to distribute free cash. If one considers current investments as part of cash and cash equivalents, all the ten top CPSEs should buyback shares.

The main motivation behind the guideline seems to be reducing the budget deficit of the central government rather than enhancing shareholder wealth. The guideline may also contradict its own recommendations. For example, ONGC is required to issue bonus shares, pay hefty dividend and also buyback shares- all in the same year! Whereas the financial statements of ONGC show that the company has already severely depleted its cash reserve from a high of 18% of total assets to only 1.2% in March 2015. It is always prudent to consider relative rather than absolute liquidity while taking a share buyback decision. One might of course argue that ONGC has spent only 7% of operating cash of past ten years in capital projects and hence clearly the company does not have any immediate need of hoarding cash. It has already paid 28% of its operating cash as dividend over the past ten years.

Hence, there is no valid reason of 'forcing' the company to go for a share buyback with such a low relative liquidity position. The guideline should have specified a relative liquidity criterion (e.g., cash as a percentage of total assets) to trigger share buyback.

Stock Split

There are two theories behind corporate motivation for stock split- first, split enhances liquidity of stocks and diversifies the shareholders; and second, it sends a signal of superior performance of the firm. Empirical evidence, however, supports the hypothesis of the liquidity theory. The DIPAM guidelines mention that whenever market price or book value of share of a CPSE exceeds 50 times its face value, the CPSE will split its shares appropriately. Figures for the financial year 2014-15 (not reported here) suggest that three out of top ten CPSEs (ONGC, NMDC and BHEL) is required to split their shares on book value basis.

However, if one looks at the market value-to-face-value multiple, there are four companies (BPCL, NMDC, HPCL and BHEL) having such multiple more than 50 and hence are required to split stocks. If one CPSE has a face value of Rs. 10 per share, the guidelines suggest that the CPSE with a book or market value of share more than Rs. 500 should consider stock split. Isn't that too predictable?

Equity restructuring is a continuous process and is used by the management as a technique to enhance the net worth of a company. Equity restructuring strategies increase the price-to-book multiple of firms. Share buyback is not that popular in India as the shares so bought back are to be cancelled. Cash dividend, on the other hand, is a more popular form of distribution of cash to shareholders. But dividend is stickier than share buyback. Hence, if a firm has to distribute a large amount of cash to shareholders, it is always prudent to opt for the buyback route.

Any restructuring action generally conveys positive signal to the market. But if the actions are pre-defined and follow some cardinal principles, there would be no surprises and market would factor in such actions in the prices much before the actual events. Splitting stock when the market price exceeds INR 500 (with a face value INR 10) is too low a level for such action. For example, 43 out of 50 NIFTY companies have share prices more than 50 times of their respective face values. If these companies start splitting stocks (some of them have already done that), the market will witness a surge in supply which may not always increase the return of the stocks.

Buyback of Shares
Buy-back of shares is a method of financial engineering. It can be described as a procedure which enables a company to go back to the holders of its shares and offer to purchase the shares held by them.

Buy-back helps a company by giving a better use for its funds than reinvesting these funds in the same business at below average rates or going in for unnecessary diversification or buying growth through costly acquisitions.

When a company has substantial cash resources, it may like to buy its own shares from the market particularly when the prevailing rate of its shares in the market is much lower than the book value or what the company perceives to be its true value.

This mode of purchase is also called 'Shares Repurchase'. A company can utilize its reserves to buy-back equity shares for the purpose of extinguishing these or treasure operations. The former option results in re-duction of the paid up capital, and consequently higher earnings and book value per share. Naturally, the market price of equity goes up.
The reduction in share capital strengthens the promoter's control and enhances the equity value for shareholders. In the latter option, companies buy their shares from open market and keep these as 'treasury stock'.

This enables the promoters to strengthen their control over the shares bought back, without any investment of their own. In case of treasure operations, there is a diversion of company's funds to buy shares and reduction in the value of equity for the shareholders.

The main aim of shares repurchase might be reduce the number of shares in circula-tion in order to improve the share price, or simply to return to the shareholders resources no longer needed by the company.

The shares repurchase may be by way of purchase from the open market or by general tender offer to all shareholders made by the company to repurchase a fixed amount of its securities at pre-stated price.

Reasons for Buy-Back:
There are reasons why a company would opt for buy-back:

1. To improve shareholder value, since buy-back provides a means for utilizing the companies surplus funds which have unattractive alternative investment options, and since a reduction in the capital base arising from buy-back would generally results in higher earnings per share (EPS).

2. It is used as a defense mechanism, in an environment where the threat of corporate takeovers has become real. Buy-back provides a safeguard against hostile take-over by increasing promoter's holdings.

3. It would enable corporate to shrink their equity base thereby injecting much needed flexibility.

4. It improves the intrinsic value of the shares by virtue of the reduced level of floating stock.

5. It would enable corporate to make use of the buy-back shares for subsequent use in the process of mergers and acquisitions without enlarging their capital base.

6. Buy-back of shares is used as a method of financial engineering.

7. It is used for signaling the effects of buy-back on the share price.

Financing Aspects of Buy-Back:
Finance is the nerve centre for the business activities and success is more depending on the better and efficient management of funds and finance. In order to buy-back of shares and securities in large numbers, the company needs huge amounts of capital and funds which may be mobilized through one or more of the sources viz.

1. Internal sources

2. Sufficient cash position

3. Selling of temporary investment with the least possible loss

4. Raising of working capital needs

5. Raising cash by issuing fixed deposits

6. Raising by issue of debentures and loan bonds

7. Cash credit from commercial banks

8. Overdraft from commercial banks etc.

Benefits of Buy Back:
The benefits derived from share repurchase program are as follows:

1. Firms whose profitability was below their industry average enjoy greater share price growth after shares are repurchased than firms whose profitability was above their industry average.

2. Firms whose sales growth was below their industry average enjoy greater share price growth after shares are repurchased than firms whose sales growth was above their industry average.

3. Profitable and growth firms that repurchase shares provide a clear indication to the investors about the strengths of the company.

4. Repurchasing firms with debt ratios below but sales growth rates above their industry average experience substantially higher share price growth after repurchasing than firms with debt ratios above but sales growth below their industry average.

5. Repurchasing firms with profitability and debt ratios below their industry average demonstrate higher share price growth after repurchasing than firms with profitability and debt ratios above their industry average.

Drawbacks of Buy Back:
The shares repurchase is criticized for the following reasons:

1. This could enable unscrupulous promoters to use company's money to raise their personal stakes.

2. It opens up possibilities for share price manipulation.

3. It could divert away the company's funds from productive investments.

Legal Provision as to Buy-Back:
Buy-back enables the company to go back to its shareholders and offers to purchase from them the share they held. With the introduction of sections 77A, 77A A and 77B in the Companies Act, 1956 through the Companies (Amendment) Act, 1999, now the companies allowed buy-back shares.

They buy-back of shares are also subject to the SEBI (Buy-back of Securities) Regulations, 1998. The said legal provisions are summarized as follows:

1. The Sources of funds for buy-back of shares or other specified securities of a company are:

    (a) Free reserves or

    (b) Securities premium account or

    (c) The proceeds of issue of any shares or other specified securities.

2. No buy-back should be made out of the proceeds of an earlier issue of same kind of shares or same kind of other specified securities.

3. Explanation to section 372A of the Act provides that 'reserves' as per the last audited Balance sheet of the company are to be taken as free reserves. The amounts credited after the close of financial year to free reserves and the securities premium account should not be utilized for buy-back.

4. The company may buy-back its own shares or other specified securities in any of the following manner:

    (1) From the existing security holders on a proportionate basis, or

    (2) From the open market, or

    (3) From odd lots, or

    (4) By purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

5. A company may buy-back its shares or other specified securities to the extend 10% of its total paid-up equity capital and free reserves by passing only a Board resolution.

6. If buy-back is beyond 10%, it must be approved by shareholders resolution. In any case, buy-back of equity shares by a company cannot exceed 25% of its total paid-up equity capital in that financial year.

7. Where the companies buy-back its own shares, it shall extinguish and physically destroy the securities so bought back within seven days of the last date of completion of buy-back.

8. A company can issue bonus shares at any time after the buy-back of shares. Regulation 19(l)(a) of the SEBI (Buy-back of Securities) Regulations, 1998, a company shall not issue any specified securities including by way of bonus till the date of closure of the offers for buy-back made under the regulations.

8. Section 77(8) prohibits further issue of shares (including allotment of further shares) under clause (a) of sub-section (1) of section 81 for a period of six months except by way of bonus shares.

9. A company can buy-back its shares every year but subject to the satisfaction of other conditions such as debt-equity ratio, limits of buy-back stipulated in section 77A etc. Promoters can participate under tender offer or buy-back through book building subject to full disclosures being made in the letter of offer.

10. A company cannot buy-back equity shares from the promoter or person in control of the company if the buy-back is through stock exchange.

11. Passing of resolution by a company does not create any obligation on the company to buy-back its securities. Buy-back becomes irrevocable only when the letter of offer is filed with the appropriate authority or public announcement of the offer to buy-back is made.

12. The company should pay the consideration only by way of cash/ cheque /bank draft.

13. The cost of buy-back of securities should be taken as an expense and charged to the Profit and Loss Account.

14. Listed companies are required to intimate the stoke exchange of general meeting and resolution passed thereof.

15. The buy-back shares of a private limited company are subject to the compliance of Private Limited Company (Buy-back of Securities) Rules, 1999.

A listed company is required to open an escrow account which is to be used as a security for the purpose of making payment in respect of buy-back of shares. The company should deposit in an escrow account opened with a scheduled commercial bank on or before the opening of the offer for buy-back of securities, such sum as specified below:

16. Where the estimated consideration payable for buy-back does not exceed Rs. 100 cores, 25% of the consideration payable.

17. In case the consideration payable for buy-back exceed Rs. 100 crores, 25% up to Rs. 100 crores and 10% of the balance.

18. The companies are required to maintain a 'Register of Securities Bought back' which should contain the prescribed information. .

19. The company is required to extinguish and physically destroy the security certificates bought back in the presence of the Registers or Merchant Banker or Statutory Auditor within seven days from the date of acceptance of securities. Mere stamping 'cancelled is not sufficient.

20. The securities offered for buy back, if already dematerialized, should be extinguished and destroyed in the manner specified under SEBI (Depositories and Participants) Regulations, 1996 and the bye-laws framed thereunder.

21. Where a company purchases its own shares out of free reserves, then a sum equal to the nominal value of the shares so purchased shall be transferred to the 'Capital Redemption Reserve' and details of such transfer shall be disclosed in the Balance sheet.

22. Disclosure are required to be made in Directors Report as to reasons for failure of buy- back, if shares are not bought back within 12 months from date of Board or Shareholders resolution.

23. A company should not keep the offer for buy-back open for a period exceeding 30 days.

Profit or Loss Prior to Incorporation:
A company may acquire another business from a date prior to its incorporation, normally from the beginning of the accounting year of the selling concern with to avoid preparation of final accounts up to the date of acquisition.

For example, a company incorporated on May 1, 1984, may purchase a business with effect from January 1, 1984, the date on which the accounting year of the vendor starts.
Suppose, the company closes its accounts on December 31 and prepares the Profit and Loss Account for the year ended December 31, 1984, any Profit earned by the company from January 1, 1984, to April 30, 1984 (i.e., Prior to incorporation) is known as profit prior to incorporation and treated as capital profit and transferred to the Capital Reserve Account.

In the same manner any loss incurred prior to incorporation is treated as capital loss and debited to the Goodwill Account. The profit earned by the company after the date of its incorporation is its revenue profit and is available for dividend.

A pertinent point to be noted is that even though a public company can earn revenue profits only after getting the Certificate of Commencement, for all practical purposes, the date of incorporation is taken as the basis for the calculation of profit prior to incorporation.

Ascertainment of Profit or Loss Prior to Incorporation:
The following steps are taken to ascertain the profit earned prior to incorporation and after incorporation.

(1) A Trading Account for the full accounting period is prepared and Gross Profit is arrived at.

(2) Gross profit is apportioned between the two periods on the basis of the sales in the two periods.

(3) All fixed expenses such as rent, rates, salaries, insurance, audit fees, etc., are allocated on a time basis as these expenses are related to the time factor.

(4) Expenses which are directly related to sales, like discount allowed, bad debts, commission on sales, advertising etc., are allocated on the basis of the sales of each period.

(5) Certain expenses which are incurred by the company or incurred only in the post-incorporation period, e.g., preliminary expenses, debenture interest paid, directors' fees, etc., are charged as expenses of the post-incorporation period only.

Illustration 1:
Mohan Company Ltd., was incorporated on 30th June 2005 to take over the business of K. Mohan as from 1st January 2005. The financial accounts of the business for the year ended 31st December 2005

	Rs.	Rs.
Sales:		
January to June	1,20,000	
July to December	1,80,000	3,00,000
Less:		
Purchases:		
January to June	75,000	
July to December	1,20,000	1,95,000
Gross Profit		1,05,000
Less:		
Salaries	15,000	
Selling expenses	3,000	
Depreciation	1,500	
Director's remuneration	750	
Debenture Interest	90	
Administration expenses(Rent, Rates etc.)	4,500	24,840
		80,160

You are requested to prepare a statement apportioning the balance of profit between the periods prior to after incorporation and show the profit and loss appropriation account for the year ended 31st December 2005.

Solution:

Profit and Loss Account for the period January 1 to December 31, 2005

	Pre-incorpo-ration	Post-incorpo-ration		Pre-Incorpo-ration	Post-Incorpo-ration
	Rs.	Rs.		Rs.	Rs.
To Salaries (1:1)	7,500	7,500	By Gross Profit		60,000
To Selling Expenses (2:3)	1,200	1,800	(Sales less purchases in	45,000	
To Depreciation (1:1)	750	750	the respective periods)		
To Director's remuneration	—	750			
To Debenture Interest	—	90			
To Administration Expenses (1:1)	2,250	2,250			
To Capital Reserve - transfer	33,300				
To Net Profit c/d	—	46,860			
	45,000	60,000		45,000	60,000

Profit or Loss Prior to Incorporation

Notes:

	Pre-incorporation		Post-incorporation
(1) Time Ratio	Jan.1, 2005 to June 30,2005	:	July 1,2005 to Dec. 31,2005
	6	:	6
	1	:	1
(2) Sales Ratio	1,20,000	:	1,80,000
	2	:	3

Illustration 2:

X. Ltd., which was incorporated on May 1, 2009, acquired a business on January 1,2009. The first accounts were closed on September 30, 2009.

The Gross Profit for the period was Rs. 42,000.

Details of other expenses:

General expenses Rs. 7,200; director's remuneration Rs. 12,000; and preliminary expenses Rs. 2,000. Rent p to June 30 was Rs. 6,000 per annum after which it was increased by 40%.

Salary of the manager, who on formation of the Company had become a whole time director and whose remuneration has been given above, was agreed at Rs. 5,100 per annum.

The Company earned a uniform Gross Profit. The sales up to September 2009 were Rs. 98,000. The monthly average of sales for the first months of the year was one-half of the remaining periods. Show the Profit and Loss Account and indicate how you would deal with the pre-incorporation results.

Solution:

Profit and Loss Accounts for the Period January 1 September 30, 2009

	Pre-incorporation	Post-incorporation		Pre-incorporation	Post-incorporation
	Rs.	Rs.		Rs.	Rs.
To General expenses 4:5	3,200	4,000	By Gross Profit 2:5	12,000	30,000
To Directors' remuneration	—	12,000			
To Preliminary expenses	—	2,000			
To Rent	2,000	3,100			
To Manager's salary	1,700	—			
To Capital reserve	5,100				
To Net Profit c/d	—	8,900			
	12,000	30,000		12,000	30,000

Notes:

	Pre-incorporation		Post-incorporation
1. Time Ratio	Jan. 1,'2009 to April 30,'2009	:	May 1,'2009 to Sept. 30,'2009
	4	:	5

2. Sales Ratio:

Let the average sales for the first 4 months be X

$\therefore$ The average sales for the next 5 months be 2X

First 4 months' sales	$= 4 \times X = 4X$
Next 5 months' sales	$= 5 \times 2X = 10X$
Sales Ratio	$= 4X : 10X$
	$= 2X : 5X$
	$= 2 : 5$

3. Rent p to May 1, 2009, is at Rs.500, i.e., 500 x 4 = Rs. 2,000

Rent for May and June—	500×2 = Rs.1,000
July, August and September—	700×3 = <u>Rs.2,100</u>

4. Salary to the manager for the first 4 months being 5,100×4/12 = Rs.1, 700.

5. Pre-incorporation profit is a capital profit — dividends cannot be paid out of it. It can be used by the directors to write off expenses and commission on the issue of shares or debentures, preliminary expenses, etc.

Illustration 3:

Poornima Ltd., incorporated on April 1, 2008, with a capital of Rs.50, 000 in equity shares of Rs. 10 each took over the running business of Poornima as from January 1,2008. The purchase price Rs. 20,000 was settled on July 1, 2008, together with interest at 10% per annum by fully paid shares for Rs. 17,500 and the balance by cheque.

To Company's Trial Balance as on December 31, 2008, was as below:

	Rs.	Rs.
Cash and Bank balances		
(Cash Rs.180)	4,860	
Share capital		22,500
Land and buildings	8,000	
Fixtures	750	
Cycles	1,000	
Salaries	1,200	
Purchases	48,500	
Sales		45,000
Debtors and creditors	4,500	3,000
Rent from tenants		600
Rent, rates and taxes	300	
Building upkeep	150	
Directors' fees	720	
Sundry charges	120	
Interest to vendor	1,000	
	71,100	71,100

Prepare the final accounts for the year ending December 31, 2008, considering the following additional details:

(1) Stock at end Rs. 14,000.

(2) Bad debts Rs.200 (including Rs.50 on debtors taken over from vendor) to be written off.

(3) Sales above include sales up to April, 1, 2008, Rs.7, 500.

(4) Provide for doubtful debts Rs.250.

(5) Depreciate buildings 5% and cycles 20%.

Solution:

Trading and Profit and Loss Account for the year ended December 31, 2008

	Rs.		Rs.
To Purchases	48,500	By Sales	45,000
To Gross Profit c/d	10,500	By Closing Stock	14,000
	59,000		59,000

Profit or Loss Prior to Incorporation

	Pre-incorporation	Post-incorporation		Pre-incorporation	Post-incorporation
To Salaries 1:3	300	900	By Gross Profit 1:5	1,750	8,750
To Rent, rates 1:3	75	225	By Rent 1:3	150	450
To Building upkeep 1:3	38	112			
To Directors' fees	—	720			
To Sundry charges 1:3	30	90			
To Interest	500	500			
To Bad debts	50	150			
To Provision for doubtful debts	—	250			
To Depreciation:					
Building 400					
Cycles 200					
1:3 600	150	450			
	757	5,803			
	1,900	9,200		1,900	9,200

Balance Sheet of Poornima Ltd. as on December 31, 2008

Liabilities	Rs.	Assets	Rs.	Rs.
Share capital	22,500	Fixed Assets:		
Reserves and surplus:		Land and buildings	8,000	
Capital reserve	757	Less: Depreciation 5%	400	7,600
Profit and Loss A/c	5,803			
Current liabilities and provisions:		Fixtures		750
Sundry creditors		Cycles	1,000	
	3,000	Less: Depreciation 20%	200	800
		Investments		Nil
		Current assets, loans and advances:		
		Stock		14,000
		Sundry Debtors	4,500	
		Less: Provision for bad debts	450	4,050
		Bank		4,680
		Cash		180
		Miscellaneous expenditure		Nil
	32,060			32,060

Workings: Time Ratio 3:9 = 1:3

Sales Ratio 7,500: 37,500= 1:5

Concept of Debt Restructuring

Debt restructuring is a process used by companies to avoid the risk of default on existing debt or to take advantage of lower available interest rates. Debt restructuring can be carried out by individuals on the brink of insolvency as well, and by countries that are heading for default on sovereign debt.

- The debt restructuring process can be carried out by reducing the interest rates on loans or by extending the dates when a company's liabilities are due.
- A debt restructure might include a debt-for-equity swap, when creditors agree to cancel a portion or all of the outstanding debt in exchange for equity in the company.
- A nation seeking to restructure its debt might move its debt from the private sector to public sector institutions.

How Debt Restructuring Works?

Some companies seek to restructure debts when they're facing bankruptcy. They might have several loans are structured in such a way that some are subordinate in priority to other loans. The senior debtholders would be paid before the lenders of subordinated debts if the company were to go into bankruptcy. Creditors are sometimes willing to alter these and other terms to avoid dealing with a potential bankruptcy or default.

The debt restructuring process is typically carried out by reducing the interest rates on loans, by extending the dates when the company's liabilities are due to be paid, or both. These steps improve the firm's chances of paying back the obligations. Creditors

understand that they would receive even less should the company be forced into bankruptcy and/or liquidation.
Restructuring debt can be a win-win for both entities. The business avoids bankruptcy and the lenders typically receive more than what they would through a bankruptcy proceeding.

Individuals can restructure their debts in various ways as well, but be sure to check the credentials and reputation of any debt relief service you're considering with your state's attorney general or consumer protection agency because not all are reputable.

Types of Debt Restructuring
A debt restructure might also include a debt-for-equity swap. This occurs when creditors agree to cancel a portion or all of their outstanding debts in exchange for equity in the company. The swap is usually a preferred option when the debt and assets in the company are very significant, so forcing it into bankruptcy would not be ideal. The creditors would rather take control of the distressed company as a going concern.

A company seeking to restructure its debt might also renegotiate with its bondholders to "take a haircut"—where a portion of the outstanding interest payments would be written off, or a portion of the principal will not be repaid.

A company will often issue callable bonds to protect itself from a situation in which interest payments cannot be made. A bond with a callable feature can be redeemed early by the issuer in times of decreasing interest rates. This allows the issuer to readily restructure debt in the future because the existing debt can be replaced with new debt at a lower interest rate.

Other Examples of Debt Restructuring
Individuals facing insolvency can renegotiate terms with creditors and tax authorities. For example, an individual who is unable to keep making payments on a $250,000 subprime mortgage might agree with the lending institution to reduce the mortgage to 75%, or $187,500 (75% x $250,000 = $187,500). In return, the lender might receive 40% of the proceeds of the house sale when it's sold by the mortgagor.
Countries can face default on their sovereign debt, and this has been the case throughout history. In modern times, they sometimes opt to restructure their debt with bondholders. This can mean moving the debt from the private sector to public sector institutions that might be better able to handle the impact of a country default.

Sovereign bondholders might also have to "take a haircut" by agreeing to accept a reduced percentage of the debt, perhaps 25% of the full value of the bond. The maturity dates on bonds can also be extended, giving the government issuer more time to secure the funds needed to repay its bondholders. Unfortunately, this type of debt restructuring doesn't have much in the way international oversight, even when restructuring efforts cross borders.

Debt restructuring provides a less expensive alternative to bankruptcy when a company, individual, or country is in financial turmoil. It's a process through which an entity can receive debt forgiveness and debt rescheduling to avoid foreclosure or liquidation of assets.

CDR and Insolvency

The concept of restructuring comes into picture when a company is facing financial difficulties, and as a result of which, it is on the verge of insolvency. Restructuring a company is done when the business operations carried out by the company is viable, but still owing to some factors, it is incurring losses. These factors can be a change in government policy, change of interest rates, change in the value of currency, etc. these factors are obviously beyond the control of the company. In such cases CDR plays an important role in giving the company another chance to survive in the market. The basic objective of CDR is to maintain the viability of the company in the long run so that interested parties do not incur any losses. The interest parties enter into different arrangements with the company like exchanging their debt for some number of shares (referred to as debt-equity swap), or forgoing a part of the loan, or the interested parties agree to a fixed moratorium period where both the parties do not institute any action against each other during the said period.

CDR is a part of the external mechanism. In the case of CDR, the company has to ensure that it has at least some assets to support the reconstructing process because once a company enters into insolvency, it does not have much choice. Drawn out insolvency also compels the company to wind up its activities, and the company loses its "separate legal entity" status. But if proper restructuring is done, the company may get a new lease of life and continue with its business operations.

CDR can be done in a number of ways. Preference shares can be converted into equity shares; overall debts can be converted into shares, a part of debt can be waived by the creditors, Inter-Creditor Agreements can be modified, contingent claims can be revalued and settled, and assets and liabilities can be redistributed.CDR includes different stages, such as making an agreement between the parties, consideration of the proposals between the parties and providing additional funds to the company at a higher rate of interest by the lenders so that the company can carry on its business activities and do not become insolvent.

Corporate Debt Restructuring in the Indian Scenario

The concept of CDR was introduced to the India when in the year 2001, the RBI came up with certain guidelines to be followed by banks and other financial institutions. The RBI stated that the concept of CDR is a non-statutory and voluntary process where if 75% of the creditors (by value) decide to aid the company, the other 25% of the creditors will also have t agree to help the company through the process of CDR.

CDR is available only to those companies which have multiple bank accounts and has taken credit from multiple lenders. Also, the outstanding amount of debt of all the creditors and lenders should be 100 million or above in aggregate. It covers all categories of assets categorized by the RBI in terms of prudential assets classification standards. Cases which are filed with the Debt Recovery Tribunal, The Bureau of Industrial and Financial Reconstruction or any other case are qualified for reconstruction under CDR. A bank or a financial institution can refer for CDR if it has a 20% share in working capital or term loan of the company.

The major benefit a creditor has from restructuring debts is that they are able to reduce the non-performing assets of a company through it.

Corporate Debt Restructuring Scheme

Corporate Debt Restructuring or CDR is a voluntary process under which banks and financial companies aid those companies, who are facing financial difficulties due to internal or external factors, to restructure their debts. CDR is a non-statutory process. The motive behind this mechanism is to provide timely support to the companies and revive them. Another motive is to protect the interest of the stakeholder, investors, and other parties who are acting as lenders to such enterprises. CDR is available to those companies which have availed credit facility from more than one financial institution. These financial come together to help the company for the benefit of all the interest parties.

Corporate Debt Restructuring, in short CDR is a scheme evolved by the Reserved Bank of India (RBI) through a circular issued on 23rd August, 2001 for implementation by banks and Financial Institutions (FIs) for realisation of amount of debt from the debtors who are not able to pay the amount in full.

It is based on a voluntary agreement between the debtor & creditor (DCA) or the creditor & creditor (ICA) whereby approval of 75% creditors i.e. Super Majority is required. It covers the multiple banking accounts and consortium or syndication of accounts where aggregate outstanding is Rs. 100 million.

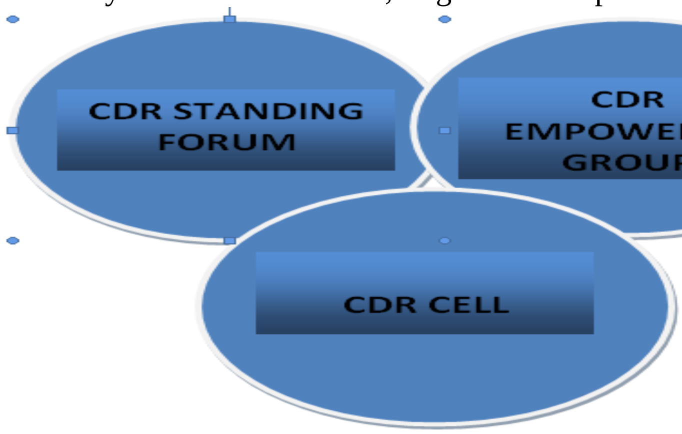
That's all about the basic framework. Now, kind of cases which are eligible for CDR are mentioned as below:-

- Debt Recovery Tribunal (DRT) Cases
- Board for Industrial & Financial Reconstruction (BIFR) Cases
- Suits filled for recovery

The further most important question is….who can Trigger CDR? and the answer is…it can be triggered by any creditor having minimum 20% share in Working Capital or term Finance or concerned corporate (if supported by bank/FIs having share as mentioned above).

The interesting fact is any application made for concealment of any fraud or misfeasance will not be allowed under this scheme but may be admitted if it is satisfied that it would rectify the default.

CDR is basically a three tier structure, as given in the pie chart below:



Let us explain all the three tiers one by one.

Firstly, CDR Standing Forum is the top most tier of the CDR Structure, it contain representative general Body of all FIs/Banks i.e. Chief Executives All Indian Financial

Institution and Scheduled Banks. It is the Monitor of CDR mechanism and it is a self-empowered body which lays down the policies and guidelines which is being followed by the CDR Empowered Group (EG). It also reviews the decisions of EG & CDR Cell. CDR Core group is also carved out from Standing Forum to perform assisting functions.
Secondly, CDR Empowered Group is the second tier of the structure which decides the cases and contains Executive Directors of FIs/ Schedule. Importantly it considers the Preliminary flash report of all cases whose request is made by the CDR Cell and if it is found that CDR is potentially viable then frames the package by referring institution in conjunction with CDR Cell.
Thirdly, CDR Cell is the last tier work in conjunction with Banks/FIs for framing report etc.Potential Viability of a case varies case to case depending upon the benchmark parameters derived through various sources e.g. Internal Rate of Return, Break Even Point, Cost of Capital, etc.

Steps under the Scheme:

• Lead/major Stakeholder work out preliminary restructuring plan with other stakeholder & submit to CDR Cell.

• CDR Cell makes initial scrutiny of proposals received within 30 days that prima facie CDR is feasible.

• If found feasible then referring banks to work out detailed plan with help of other lenders in conjunction with CDR Cell (experts engage from outside, if required) & if not feasible then lenders may start action for recovery of their dues.

• EG approve or suggest modification to restructuring plan. (final decision taken within 90 days……may extend to 180 days in genuine cases)

• The plan is monitored by MONITORING COMMITTEE (MC), It is constituted by EG at time of approval consist of representative of referring banks/FIs.

Another important part here is that, Borrowers are classified in 4 classes as given below:

1. Category A: Companies unable to pay due to external factors e.g. economy, industry etc.
2. Category B: Companies unable to pay due to external factors and also due to weak resources, inadequate vision and lack of professional support.
3. Category C: Borrowers are overambitious and diversified into unrelated fields with or without lenders permission.
4. Category D: Financially undisciplined borrowers.

It is a scheme made for those who are unable to pay the sum in full where some debt is forgiven by creditor in exchange of equity position in company.