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DECODING THE TAKEOVER CODE

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ABSTRACT

"Change or Die" as the saying goes is the essence of life not only for the potential human race but also for the gigantic organizations run by them. As we all know the change or in a properly defined manner for any organization i.e. restructuring is very important. In a layman language restructuring can be defined as the change of the basic structure. Every organization small or big has to go through certain changes that may be big or small.

Acquisition and Takeovers are the powerful tools to achieve corporate growth, but because of their complex nature, to protect the interest of all the parties, to maintain transparency and to facilitate orderly development these activities are regulated by a takeover code in most part of the world. In India after liberalization Govt. started to regulate these activities by introducing a takeover code. This code has gone through various major and minor changes since then to respond the challenges it faced during implementation and also to overcome its shortcomings. With the rise of India as an emerging fastest growing economy in the world and the present impact of Takeovers, Mergers and Acquisitions which has a prominent impact on the organizations leading to a significant change in their organizational structure. So, is there any change in the Takeover Code for the Indian economy? I guess the answer is yes.

Keywords: *Takeovers, Mergers, Trigger, Acquisition, Threshold limit.*

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INTRODUCTION

WHAT ACQUISITION/TAKEOVER MEANS?

Acquisition refers to the process in which a person or firm acquires controlling interest in another firm. Acquisition can be friendly or hostile. A friendly acquisition is one in which management of the target company or controlling group sells its controlling shares to another group at its accord. Acquisition can take market route also. If management of the target company is unwilling to negotiate a contact with prospective acquirer, it can approach directly to the shareholders of the target company by making an open offer. This is known as Hostile takeover. Takeovers are governed by 'SEBI Regulation for Substantial Acquisition of Shares and Takeover' (most popularly known as Takeover code)

TAKEOVER CODE – IT'S MEANING

In business, a takeover is the purchase of one company (the target) by another (the acquirer, or bidder). The laws relating to takeover's in India where not very systematic until the year 1994 because laws relating to takeovers in India until 1994 hardly existed. Except for certain provisions of the Companies Act, 1956 there was hardly anything solid enough to be called as systematic takeover laws.

Securities and Exchange board of India (Substantial acquisition of shares and takeover) 1994 were the first to attempt to redefine the Takeover regulations in India. Under the great stewardship of Justice P.N Bhagwati the necessary regulations and amendments were formulated for the act. The regulations were amended in 1997 and they finally were implemented. Since then the regulations have been known as, Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Guidelines, 1997 or TAKEOVER CODE and till now there had been a lot of amendments made to this regulation.

The objective of the Takeover code is to regulate in an organized manner the considerable acquisition of shares and takeovers of a listed company i.e. company whose shares are listed on a stock exchange. In a limited sense these regulations also apply to certain unlisted companies including a body corporate incorporated outside India to an extent where the acquisition results in the control of a listed company by the acquirer.

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SOME IMPORTANT DEFINITIONS

• Threshold limit:

It is the level of holding when holders have to observe certain provisions. Threshold limit is defined for two purposes. First, For the purpose of Disclosure; if a person holds 5%, 10% or 14% then at each level, he has to inform to concerned company and stock exchange about the level of his holding. Second, as the trigger point for open offer; it shows the level of holdings beyond which acquirer have to make open offer for further acquisition of shares or voting right.

• Open Offer:

It is an invitation to the shareholders of the target company to surrender/sell their shares to acquirer at a specified price on or before of the closure of the offer period.

• Conditional offer:

It's an open offer to the shareholders where acquirer makes a provision that he will accept the shares only if response is beyond a certain limit.

• Trigger Point:

It's Level of holdings under various circumstances beyond which the provisions of takeover code will be applicable.

• Negotiated Offer:

It is friendly takeover where shares are acquired from substantial holder (either promoters, management, Banks and FIs etc.) on negotiation basis.

• Bail -Out Takeover

It refers to the process of rehabilitation of a financially weak company by a public financial institution or Bank.

• Creeping Facility:

A facility provided to the promoters of the company to increase their stake each year by a certain maximum limit.

• Person acting in concern:

It can be a person or firm or merchant banker or other who together works for a common cause of acquiring stake

Definition of Takeover Code of 2011

The Takeover Code, 2011 explicitly states that it shall apply to direct or indirect acquisition of shares or voting rights in or control over any target company. Shares as defined under the Takeover Code, 2011 include depository receipts also. Further, the Takeover Code, 1997 excluded preference shares from the definition of shares vide an amendment of 2002. However, this exclusion has been removed in the Takeover Code, 2011 and therefore now shares would include, without any restriction, any security which entitles the holder to voting rights.

The Takeover Code, 2011 defines acquisition as "directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company" ("Acquisition"). Since Target Company has been defined in the Takeover Code, 2011 to mean a public listed company ("Target Company"), Acquisition for the purpose of the Takeover Code, 2011 can be broadly defined as the direct or indirect acquisition of shares or control or voting rights in a public listed company. An acquirer under the Takeover Code, 2011 is therefore any person who either directly or indirectly or with or through persons acting in concert engages in such Acquisition ("Acquirer").

<u>Regulations regarding limits according to which shares shall be acquired</u>:

Takeover Code, once a company acquires 15% or more of voting rights in a target company, it has to make a mandatory open offer for an additional 20% shares. The new slabs indicate that only with 25% share, a new shareholder will get a representation in the board room, that too for voting on special issues. Securities and Exchange Board of India ('SEBI') recently relaxed the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ('SEBI Takeover Code') which governs the takeovers of listed companies in India. As per the existing provisions of the SEBI Takeover Code, no acquirer shall acquire shares or voting rights (taken together with shares or voting rights, if any, held by him or by persons acting in concert with him) of 15 percent or more in a listed company without making an open offer to acquire a minimum of 20 percent of such listed company's shares from the public shareholders.

The regulation for the minimum amount of shares to be acquired and a public announcement to be made in accordance with it are given under regulations 10, 11 and 12.

a) Regulation 10- According to this regulation, no person either alone or with someone acting with the same intention shall acquire shares in a company that would enable the person or persons to practice more than 15% voting rights. The regulations further say that, this could only be done by a person who

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has made public announcement to acquire such shares in accordance with the regulations. In other words a person by himself or with a person acting with the same intention shall make a public offer to acquire a minimum of 20% of shares in accordance with the regulation.

b) Regulation 11- This regulation talks about an Acquisition by a person or two or more persons acting together with common intention, who have already acquired 15% or more but less than 55% of share or voting rights, which would enable them to exercise further 5% but not more voting rights in the same financial year ending on 31st March .Though this can be done if the acquirer makes a public offer to acquire such shares in accordance with the regulations. The regulation further talks about acquirers who already have 55% or more shares but less than 75% shares of the target company but intend to acquire more shares, this can only be done if the acquirer makes a public announcement in this regard

c) Regulation 12- The regulations further say that, any control over the company shall not go into the hands of the acquirer irrespective of whether acquisition of shares or voting rights has taken place or not, until a public announcement to acquire such shares has been made in accordance with the regulations.

An important point to be noted from the summary of regulations above is that not only the acquisition of shares but also the acquisition of voting rights would also constitute substantial acquisition. It is to be noted that voting rights of a shareholder are accompanied with the shares of the company. Until a person is a registered shareholder of a company he cannot have the voting rights, but there are cases when a person has paid the consideration for the share but an official instrument of share transfer has not been formulated, in such case a power of attorney to transfer the voting rights of the transferor can be formulated or the transferee may demand for a proxy from the transferor or he may make the transferee exercise the voting rights as he demands. Maybe this was the reason why acquisition of voting rights have been expressly mentioned in the regulations as far as substantial acquisition is concerned.

The trigger point for mandatory open offer has been raised from 15% to 25% of the voting capital of a listed company this could be a threat to promoters with less than 25%. In India "Only 6% of listed companies have 15-25% promoter stake. So that number is not very large but in these cases some of them are significant companies”. While no change has been recommended in the annual creeping acquisition limit of 5%, as per the draft creeping acquisitions be permitted only to acquirers who already hold more than 25% of the voting capital, provided the aggregate post-acquisition shareholding does not exceed the maximum permissible non-public shareholding.

This increase in threshold would definitely require for financing options which can put Indian banks back visa their global peers as Indian banks face restrictions for lending for take over’s and this will a great disadvantage for the domestic firms. Indirectly it would boost to companies wanting private equity money to raise the cash. Moreover this hike in limit can also pave the way for overseas players like Black stone and Teamusk to have a strategic stake in Indian companies, taking into account of the growth story of India and the resilience of the economy even during the subprime and then European sovereign debt crisis PE players won’t shy from prospect of 100% buyout.

As per the panel acquisitions that cross the 25-percent limit should be followed by an open offer for all the shares of the target company i.e. 100% buyout. At present open offers need to be only for 20 percent of public shareholding so this would definitely increase the cost of acquisition and stretch the balance sheets of Indian companies because earlier with 20% offer acquirer could actually control the acquired company a little bit, but at the other side all minority/retail investors would get equal opportunity to tender their shares to open offers so retail investors would enjoy the same exit price as the promoters so the basic philosophy of the code is equitable and fair treatment of all the share holders.

The increase in the threshold to 24.9% will limit a promoter's vulnerability but promoters that face hostile bids will also find it difficult to protect their company as any counter offer has to be for 100% shares of the company. The higher size is also likely to act as a deterrent because the cost of acquisition will surge, as it will be a costly preposition, especially if it is done in a company where promoters’ stake is low. The takeover financing will surge up to three times. For instance, under the existing rules, if the promoters’ stake is 51 per cent, the acquirer could come out with an open offer for another 20 per cent and his cost of acquisition will be 71 per cent. Under the new rules, the acquirer will have to buy 51 per cent and provide outlay for the remaining.

In India any shareholder having holding more than 25% can veto any changes in the company indirectly these holders become powerful since now its easier to reach the 25% threshold M&A activities will become more feasible though it will result in foray of only serious players in the market who are committed for the business and the capacity to shell out more capital.

However, as an exception to the 100% offer rule, the committee has stated that a voluntary open offer can be made for the acquisition of shares representing at least 10% but shall not exceed such number of shares which will take the holding of the acquirer beyond the maximum permissible non-public shareholding under the listing agreement.

This proposal would also make easier for the companies to delist the target companies if the acquirer holds more than 90% of the target company

As regards the pricing of the open offer, the committee has recommended that the price should be the highest of the following four parameters:

- The negotiated price under the agreement that attracted the open offer;
- Volume-weighted average price paid by the acquirer in the preceding 52 weeks;
- Highest price paid by the acquirer during the preceding 26 weeks;
- Sixty trading day volume weighted average market price

Public Governance

Acquisition of direct or indirect control of a listed company cannot now be undertaken without making a public announcement of an open offer. In the existing SEBI Takeover Code, explanation to Regulation 12 dealt with indirect acquisition through acquisition of holding companies – foreign or Indian. The Draft Code elaborately prescribes processes for dealing with indirect acquisition of shares or control and have an equally detailed offer price determination mechanism in Regulations 5 and 8. New concepts like primary acquisition, disclosure of the intention or the decision to make the primary acquisition and its announcement in the public domain have been introduced in the context of indirect acquisitions, which will be subject to expert scrutiny in the very near and short term. Important market-linked regulations must always be controlled and should be minimized through proper control.

Earlier Impact on Indian Multinationals

The U.S. gives substantial freedom to both acquiring and target companies. The EU requires the acquiring company to make a bid for all outstanding shares. The difference is because business cultures vary. It is in the interest of the market, and the interest of the acquirer.

Two relevant questions arise. First, how will the acquirer fund the takeover bid? In the other countries, there are facilities for funding acquisitions. No such facilities exist in India. Until these are in place, the acquirer will have to draw on internal resources or borrow abroad. The latter exposes the company to an additional currency risk. It is also possible that shareholders in the acquired company may be paid through exchange of shares.

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The second question is that the 100 percent mandatory acquisition of shares will conflict with SEBI regulation that 25 percent of the shares should be with the public.

Road Ahead:

The flow of FDI has created an imperative requirement for the government to find a solution for companies to deal with the Takeover Code as the refusal from the Securities & Exchange Board of India to provide a special dispensation for foreign investors. The new rules mandate an open offer for an additional 26% stake by an entity buying more than 25% stake in a listed company. As a result, sectors such as civil aviation, where up to 49% FDI is permitted, will be affected by the move.

It has been suggested that the foreign investors who are looking forward to invest in the Indian companies operating where the FDI is restricted to 26% or 49%, should first acquire the shares from open market and then tap the promoters for further stakes.

The main question arises as the industry is demanding the 26% acquisition to be allowed, SEBI says that it cannot change the rules just to benefit a few promoter groups. Several companies are complaining that the new rules are not to their advantage and are putting more burden on them.

Drawbacks of the Code

1. De- listing of companies would be an option but, which could have an adverse effect on the image of the company.
2. Vulnerable to the market as
3. Advantages for the foreign buyers over their Indian counterparts.

Benefits

1. Will protect the interests of the investors in the target company as now they will get an open offer for the value of their shares at market price i.e. 100% buyout.
2. Promoters will be benefitted as the values of their shares will no more be left undervalued from takeover threat.
3. The initiative will help India's M&A to be more streamlined and regulated and help to be in comparison with western markets.

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CONCLUSION

The Takeover Code of 2011 is a timely and progressive regulation that would facilitate investments and attract investors. Even though SEBI has not implemented all the suggestions of the Achuthan Committee, it has still taken into consideration some of the major issues that had been plaguing the industry till now. It has tried to maintain a balance between the concerns of the investors as well as that of the promoters. It has got both pro and cons like all other laws. Takeover code 2011 will prevent malfunctioning while takeovers and acquisitions but can harm interest of promoters at same time. Several companies are complaining that the new rules are not to their advantage and are putting more burden on them.

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