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The Nature Of The Market For Corporate Control In India

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THE NATURE OF THE MARKET FOR CORPORATE CONTROL IN INDIA

*Umakanth Varottil**

Abstract

Given its deep and liquid stock markets, India presents a favourable environment for public takeovers. In order to develop and regulate takeover activity, India's securities regulator the Securities and Exchange Board of India (SEBI) has enacted specific regulations. While at a broad level these regulations appear to attribute their origins to the United Kingdom (UK) and other countries that have adopted the UK model or its variants, I argue in this paper that takeover regulation in India bears fundamental differences and unique characteristics that have necessitated special treatment.

Due to the prevalence of concentrated shareholdings in Indian companies, the incidence of hostile takeovers has been negligible. While SEBI's takeover regulations do not confer much power to the target's board to set up takeover defences, the nature of concentration of shareholdings and other factors offer sufficient protection to incumbent shareholders and managements against corporate raiders. Hence, substantial attention in India is focused on the mandatory bid rule (MBR), which operates to grant equality of treatment to minority shareholders by conferring them an exit option in case of a change in control. India's takeover regulations are arguably stringent in implementing the MBR. This impedes value-enhancing takeovers unless they are effected with the concurrence of the controlling shareholders, who could potentially block them.

Added to this, India's takeover regulations confer benefits on incumbents that would impede a market for corporate control in the conventional sense. For example, promoters can take advantage of creeping acquisition limits, and also certain exemptions from the MBR when they enhance their positions in the company. Hence, while the takeover regulation overtly appears designed to engender a market for corporate control, its operation coupled with the corporate structure and culture in India attenuate the possibility of takeovers.

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Relying upon the political economy of takeover regulation, and more specifically the interest group theory, my goal in this paper is to demonstrate the influence of promoters in shaping India's takeover regulation. I seek to do so both analytically and empirically. While the Indian markets have witnessed a constant stream of takeovers, they are almost entirely organized changes of control in a friendly manner that trigger the MBR. Voluntary, unsolicited offers that are common in the more developed markets are miniscule in number in India.

Key Words: Takeover regulation, market for corporate control, mandatory bid rule, India

I. Introduction

A fundamental role of takeover regulation is to promote and maintain a vibrant market for corporate control.¹ This concept is apposite in corporate structures with dispersed shareholding where it can be used to address the agency problems between shareholders and managers.² However, it applies with much less force in companies with concentrated shareholding where the dominant shareholders are able to prevent takeovers with the sheer strength of their shareholding. Accordingly, the market for corporate control may be far less effective as a governance mechanism to address the agency problems between controlling shareholders and minority shareholders that are rampant in the context of concentrated shareholding.

In practice, however, takeover regulation in different jurisdictions (particularly in emerging markets)³ tend not to fully grasp these nuances due to which their effectiveness could be varied. While there may be superficial similarity (and possibly formal convergence) between takeover regulations in different countries, their manner of operation in fact could be substantially different indicating divergence at a functional level. Theoretically speaking, one emerging strain of literature attributes this phenomenon to the role of interest groups in shaping regulations that cater to the specific groups,⁴ but which may not be optimal in the overall sense. The interest groups could comprise managers, controlling shareholders such as business families and the state, or even other stakeholders. The literature at present extends to the developed markets such as the United States (US), the United Kingdom (UK) and Japan, and the emerging market of China. In this paper, I propose to explore this puzzle in the context of takeover regulation in another emerging market, India.

¹ The concept of a market for corporate control suggests that inefficiently run firms could be subject to a takeover, and the existence of such a possibility will, in itself, impel companies to enhance their governance structures and practices, in order to avoid being taken over. This supplements internal governance mechanisms such as board independence, audit and the like. F.H. Easterbrook and D.R. Fischel, 'The Proper Role of a Target's Management in Responding to a Tender Offer', *Harvard Law Review*, 94 (1981), 1161-204.

² R. Kraakman, et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 2nd edn (Oxford: Oxford University Press, 2009), p. 35 (referring to agency problems as conflicts of interest among various corporate constituencies).

³ J. Armour, J.B. Jacobs and C.J. Milhaupt, 'The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework', *Harvard International Law Journal*, 52 (2011), 219-85; C. Xi, 'The Political Economy of Takeover Regulation: What Does the Mandatory Bid Rule in China Tell Us?', *Journal of Business Law* [2015], 142-64.

⁴ *Ibid.* See also, J. Armour and D.A. Skeel, Jr., 'Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation', *Georgetown Law Journal*, 95 (2007), 1727-94.

Given its deep and liquid stock markets,⁵ India presents a favourable environment for public takeovers. In order to develop and regulate takeover activity, India's securities regulator the Securities and Exchange Board of India (SEBI) has enacted specific regulations. While at a broad level these regulations appear to attribute their origins to the UK and other countries that have adopted the UK model or its variants, I argue in this paper that takeover regulation in India bears fundamental differences and unique characteristics that have necessitated special treatment.

Due to the prevalence of concentrated shareholdings in Indian companies, the incidence of hostile takeovers has been negligible. While SEBI's takeover regulations do not confer much power to the target's board to set up takeover defences, the nature of concentration of shareholdings and other factors offer sufficient protection to incumbent shareholders and managements against corporate raiders. Hence, substantial attention in India is focused on the mandatory bid rule (MBR), which operates to grant equality of treatment to minority shareholders by conferring upon them an exit option in case of a change in control.⁶ India's takeover regulations are arguably stringent in implementing the MBR. This impedes value-enhancing takeovers unless they are effected with the concurrence of the controlling shareholders,⁷ who could potentially block them.

Added to this, India's takeover regulations confer benefits on incumbents that would impede a market for corporate control in the conventional sense. For example, promoters can take advantage of creeping acquisition limits, and also certain exemptions from the MBR when they enhance their positions in the company. Hence, while the takeover regulation overtly appears designed to engender a market for corporate control, its operation coupled with the corporate structure and culture in India diminishes the possibility of takeovers.⁸

⁵ India's capital markets have witnessed exponential growth since the liberalization of its economy in 1991. See F. Allen, R. Chakrabarti and S. De, 'India's Financial System', Working Paper (2007) (available at <http://ssrn.com/abstract=1261244>).

⁶ The MBR requires any person acquiring control of a public listed company to make an offer to acquire the shares of the remaining shareholders at no less favourable terms than that it offered to acquire control. See W.D. Andrews, 'The Stockholder's Right to Equal Opportunity in the Sale of Shares', *Harvard Law Review*, 78 (1965), 505-63, pp. 515-6.

⁷ In India, controlling shareholders are referred to as "promoters", an expression which has specific legal connotations under law.

⁸ For a discussion on the role of culture in mergers and acquisitions in India, see A. Afsharipour, 'Rising Multinationals: Law and the Evolution of Outbound Acquisitions by Indian Companies', *UC Davis Law Review*, 44 (2011), 1029-89, p. 1077.

Relying upon the political economy of takeover regulation, and more specifically the interest group theory, my goal in this paper is to demonstrate the influence of promoters in shaping India's takeover regulation. I seek to do so both theoretically and empirically. While the Indian markets have witnessed a constant stream of takeovers, they are almost entirely organised changes of control in a friendly manner that trigger the MBR. Voluntary, unsolicited offers that are common in the more developed markets are miniscule in number in India. This calls for a fundamental rethink in Indian takeover regulation. While India's takeover regulations have witnessed wholesale reforms, the approach thus far has been dictated by pragmatism. As a result, it has paid short shrift to vital philosophical underpinnings, which need to be revisited.

Part II of this paper outlines the evolution of takeover regulation India and sets out some empirical trends. Part III discusses the unique features of MBR in India, as that has been the mainstay of takeover regulation. Part IV analyses certain characteristics of takeover regulation such as the creeping acquisition mechanism and exemptions from the MBR that bolster the position of incumbents. Part V examines the extent to which hostile takeovers are possible in Indian companies. Based on the theoretical and empirical discussion in this paper, Part VI discusses the influence of interest groups in Indian takeover regulation and makes some normative observations. Part VII concludes.

II. Evolution of Takeover Regulation; Offer Trends

Takeover regulation in India has witnessed a chequered history. It has undergone significant course corrections within a short span of time, and has received considerable regulatory and judicial attention. Takeovers were regulated since the 1980s under the listing agreement entered into by listed companies with the stock exchange. The listing agreement prescribed the MBR and also provided for disclosure of substantial shareholding at 5%.⁹ But, with the establishment of SEBI as a stock market regulator in 1992, it framed a separate set of regulations for takeovers.¹⁰ Consequently, SEBI issued the first set of takeover regulations in 1994.¹¹ However, difficulties quickly emerged in their operation, and hence SEBI constituted a committee under the chairmanship of P.N.

⁹ J. Sarkar and S. Sarkar, *Corporate Governance in India* (New Delhi: SAGE Publications, 2012), p. 423.

¹⁰ Although SEBI's regulations are in the form of subsidiary legislation, they are commonly referred to as the 'Takeover Code'.

¹¹ SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994 (the '1994 Code').

Bhagwati, a former Chief Justice of India, to review them.¹² Based on the recommendations of the committee, a new Takeover Code was issued in 1997.¹³ This Code too was amended frequently to keep pace with market developments as well as regulatory and judicial pronouncements. In fact, until 2010, this Code was amended as many as 23 times, with one major round of revisions being recommended by a reconstituted Bhagwati committee in 2002.¹⁴ Due to the rapid market developments and tremendous increase in takeover activity, SEBI decided to review the Takeover Code once again in 2009 when it appointed another committee under the chairmanship of Mr. C. Achuthan.¹⁵ Based on the report of this committee known as TRAC, SEBI issued a newer Code, which came into effect in October 2011 that forms the present landscape in takeover regulation in India.¹⁶

These developments indicate the frenetic rulemaking activity by SEBI that has led to constant change in the regulatory regime. Although both the Bhagwati Committee and TRAC considered the takeover regimes of 14 different countries,¹⁷ some of the key recommendations appear to have been influenced by takeover regulation in the UK and countries that have adopted similar regulation.

In the background of regulatory developments, I now analyse trends in the market for corporate control. Table 1 sets out the descriptive statistics for takeover offers in India in the last 18 years since the 1997 Code.¹⁸ These are categorised based on the objectives of the offers, as indicated by the acquirers while making the offer.¹⁹

¹² Securities and Exchange Board of India, *Justice P.N. Bhagwati Committee Report on Takeovers* (18 January 1997) (available at <http://www.sebi.gov.in/commreport/bagawati-report.html>) (the 'Bhagwati Report 1997').

¹³ SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (the '1997 Code').

¹⁴ Securities and Exchange Board of India, *Report of the Reconvened Committee on Substantial Acquisition of Shares and Takeovers Under the Chairmanship of Justice P.N. Bhagwati* (May 2002) (available at <http://www.sebi.gov.in/takeover/takeoverreport.pdf>) (the 'Bhagwati Report 2002').

¹⁵ Securities and Exchange Board of India, *Report of the Takeover Regulations Advisory Committee Under the Chairmanship of Mr. C. Achuthan* (19 July 2010) (available at <http://www.sebi.gov.in/commreport/tracreport.pdf>) (the 'TRAC Report').

¹⁶ SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the '2011 Code').

¹⁷ Bhagwati Report 1997, para. xiii; TRAC Report, p. 10.

¹⁸ The statistics under the 1994 Code have been omitted because the data are not entirely comparable with the subsequent Codes.

¹⁹ The three categories of offers reflect the specific provisions of the Takeover Code under which they are made. However, if multiple provisions are attracted, then the relevant takeover is reflected under only one category and not all. This would avoid double counting. For instance, when an offer made amounts to 'substantial acquisition' and 'change in control of management', then SEBI usually classifies that as a 'change in control of management', which partly explains the disproportionately high incidence of offers of that type, especially in recent years. Email dated 17 June 2015 from an officer of SEBI's legal department (on file with the author).

Table 1
Substantial Acquisition of Shares and Takeovers

Year	Open Offers							
	Change in Control of Management		Consolidation of Holdings		Substantial Acquisition		Total	
	No.	Amount (Rs. crore) ²⁰	No.	Amount (Rs. crore)	No.	Amount (Rs. crore)	No.	Amount (Rs. crore)
1997-98	17	143	10	340	13	96	40	578
1998-99	29	100	25	587	12	327	66	1,014
1999-00	43	260	9	71	23	130	75	461
2000-01	70	1,140	5	189	2	42	77	1,372
2001-02	54	1,756	26	1,815	1	39	81	3,610
2002-03	46	3,814	40	2,573	2	1	88	6,389
2003-04	38	395	16	197	11	1,003	65	1,595
2004-05	35	3,503	12	165	14	964	61	4,632
2005-06	78	3,252	9	119	15	709	102	4,080
2006-07	66	6,771	15	4,498	6	83	87	11,352
2007-08	78	11,657	28	13,254	8	3,796	114	28,706
2008-09	80	3,713	13	598	6	400	99	4,711
2009-10	56	3,648	14	1,761	6	448	76	5,857
2010-11	71	10,251	17	8,902	14	145	102	19,298
2011-12	57	18,726	8	286	6	294	71	19,305
2012-13	14	836	38	8,419	27	2,904	79	12,159
2013-14	59	7,721	10	37,644	6	46	75	45,411
2014-15	51	5,442	1	11,449	8	350	60	17,241
Aggregate for the period	942	83,128	296	92,867	180	11,777	1,418	187,771

²⁰ The amounts have been reflected in “crores” of rupees, which is the basis on which SEBI data are available. One crore equals ten million (1 crore = 10 million).

Source: SEBI, Handbook of Statistics on Indian Securities Market (except for 2014-15, which is from SEBI Statistics on Open Offers)

During the 18-year period under study, a total of 1,418 takeover offers were made under the Takeover Code, with an aggregate offer size of Rs. 187,771 crores (being Rs. 1877.71 billion that translates to approximately US\$ 29.5 billion).²¹ In terms of the number of offers, a total of 942 offers (66%) involve changes in control of management, with the balance being distributed between consolidation of holdings (21%) and substantial acquisition (13%). This suggests that two-thirds of the offers are made by outsiders who are acquiring control over the company from the incumbents. But, a review of the offer sizes portrays a different picture altogether. Consolidation of holdings constitutes the highest at 49.46%, followed by change in control of management at 44.27%, with substantial acquisitions at 6.27%. Nearly half the volume of the offers made during the period involve incumbents entrenching themselves further by acquiring more shares rather than control changing hands.²² This has a significant dilutive effect on the market for corporate control.

In order to analyse the data further, it would be useful to study the trends across the time-series on an annual basis.

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²¹ The conversion has been carried out on the exchange rate prevailing on 26 June 2015.

²² At the same time, the data is somewhat skewed owing to a single large transaction in 2013-14 involving Unilever plc consolidating control over its Indian subsidiary Hindustan Unilever Limited for a sum of Rs. 29,220 crores. If this transaction is eliminated from the dataset, the position would be that of change in control of management (52.43%), consolidation of holdings (40.14%) and substantial acquisition (7.43%).

Figure 1
Takeover Trends by Number

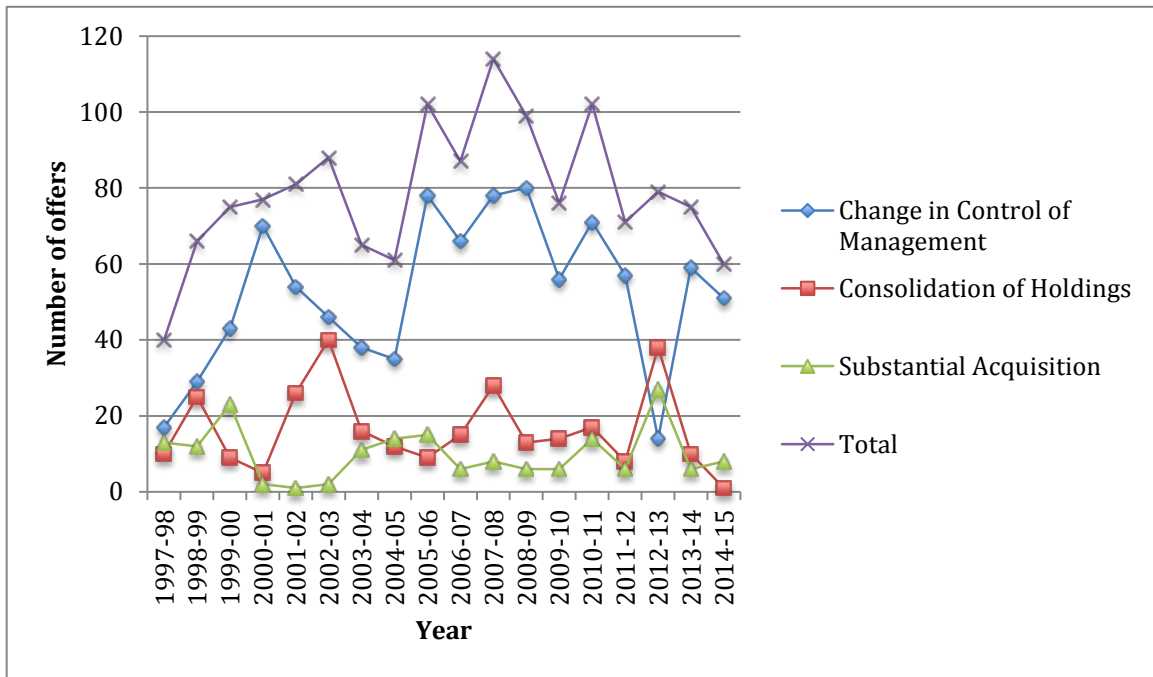
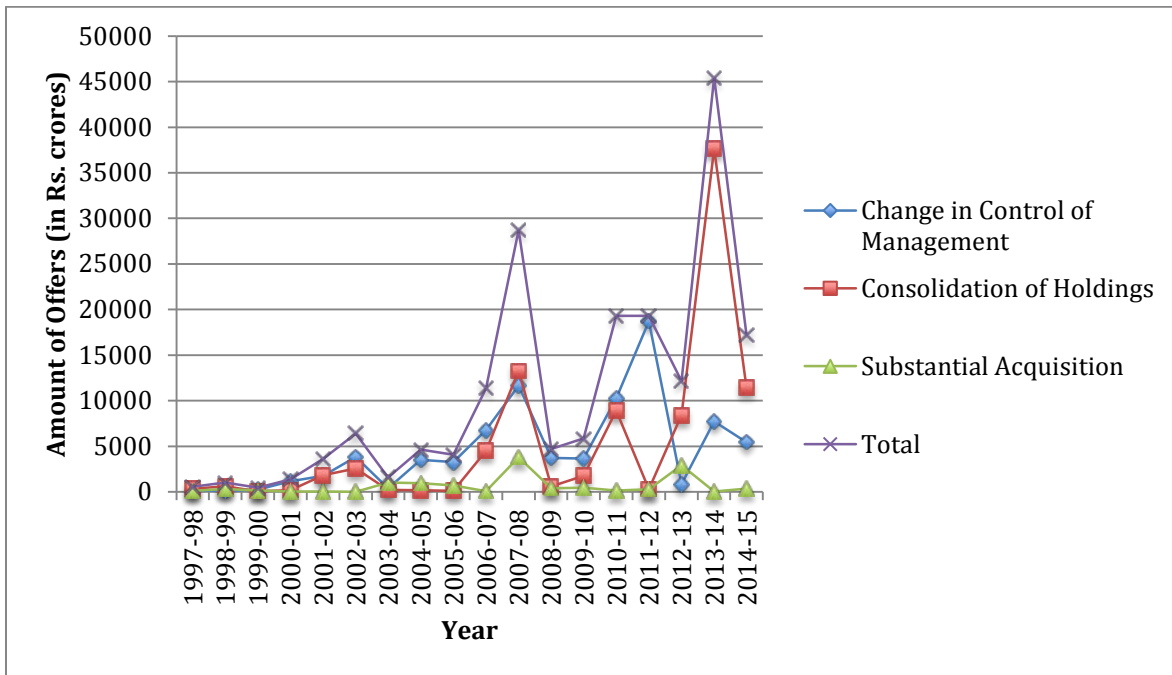


Figure 1 does not indicate any particular trend as to the number of takeover offers. The only significant factor is that takeovers of Indian firms in the aggregate peaked in 2007-08, which is consistent with the surge in mergers and acquisitions activity during the period preceding the global financial crisis. There has been a reduction in the number of offers since 2011-12, which is perhaps attributable to the slight dip in the growth rate of the Indian economy during that period. Moving to the types of takeovers, it is clear that takeovers have been driven substantially by change in control of management, which has been the most prominent form except for the year 2012-13 when that particular type of activity dipped. In all, it has been observed that there is “a takeover wave like phenomenon in the Indian market for corporate control”.²³

²³ Sarkar and Sarkar, *Corporate Governance in India*, p. 431.

Figure 2
Takeover Trends by Amount



As for the total offer size, the trend appears quite stable until 2005-06, after which there is a discernible rise and fall in volumes, with an absolute peak in 2013-2014.²⁴ Breaking down the analysis into the types of offer, in most years there is no significant gap between change in control of management and consolidation of holdings. In fact, in several years the volume of consolidation of holdings was far in excess of change in control of management (particularly in 2013-14) when consolidation represented 83% of that volume.²⁵

It would also be useful to determine how many of these offers were voluntary and how many were mandatory (on account of triggering the MBR). This data is not readily available from statistics published by SEBI, but I seek to ascertain the position through a hand-collected dataset by reviewing the public announcement of offers made during the three-year period from 2012-13 to 2014-15.²⁶

²⁴ The distortion in that year is represented by a single large takeover offer. See n. 22 above.

²⁵ Of course, a large part of that is attribute to the single deal mentioned in n. 22 above.

²⁶ These data have been collected from “SEBI Statistics on Open Offers”, which SEBI maintains under a database separate from the Handbook of Statistics on Indian Securities Market that has been used for Table 1. Hence, there could be minor variations in the number and amount of offers between the two sets of data.

Table 2
Voluntary and Mandatory Offers

Year	Open Offers					
	Voluntary		Mandatory		Total	
	No.	Amount (Rs. crore)	No.	Amount (Rs. crore)	No.	Amount (Rs. crore)
2012-13	7	5,702	72	5,199	79	10,901
2013-14	3	37,505	72	7,906	75	45,411
2014-15	3	70	57	17,171	60	17,241
Aggregate for the period	13	43,277	201	30,276	214	73,533

Table 2 indicates that 201 offers (94%) made during the three-year period were mandatory offers while only 13 (6%) were voluntary. However, looking at the amounts involved in the offers, they present a different picture, with an aggregate offer size of 59% attributable to voluntary offers and 41% to mandatory offers.²⁷ This might give the impression that a few voluntary offers of large sizes indicate the existence of a market for corporate control, at least in terms of amounts and not in number of offers. To test this, I examine the voluntary offers in greater detail.

²⁷ A substantial part of this again is owing to one single offer. See n. 22 above.

**Table 3
Object of Voluntary Offers**

Year	Voluntary Offers							
	Change in Control of Management		Consolidation of Holdings		Substantial Acquisition		Total	
	No.	Amount (Rs. crore)	No.	Amount (Rs. crore)	No.	Amount (Rs. crore)	No.	Amount (Rs. crore)
2012-13	1	201	2	5,304	4	197	7	5,702
2013-14	-	-	3	37,505	-	-	3	37,505
2014-15	1	7	-	-	2	63	3	70
Aggregate for the period	2	208	5	42,809	6	260	13	43,277

This analysis shows that voluntary offers are dominated by acquirers seeking to consolidate their control.²⁸ Hardly any voluntary offers are aimed at a change in control of the target. The absence in the Indian markets of voluntary (unsolicited) offers intended to alter control of the target suggests the lack of a market for corporate control that exists in countries such as the US and the UK.

In concluding this section, it is clear that while change in control of management constitutes a high proportion in number of takeover offers in India over the last 18 years, consolidation of shareholdings constitutes a high proportion in volume. This is true of mandatory offers as well as voluntary offers. A significant inference that emanates from this outcome is that outsiders tend to acquire control over smaller targets while incumbents tend to entrench themselves further in larger companies. Consequently, incumbents appear willing to employ substantial resources to extend their dominance over companies they already control.

²⁸ This conclusion operates even if I were to exclude from the analysis one exceptional offer as discussed in n. 22 above.

With this legislative and empirical background, I now analyse certain specific aspects of takeover regulation to determine the extent to which it promotes a market for corporate control in India.

III. The MBR at the Core of Takeover Regulation

The MBR has become the mainstay of takeover regulation in India.²⁹ Rooted in the principle of equal opportunity to shareholders, the rule requires control premium in case of a takeover to be shared among all shareholders, including the minorities.³⁰ In addition, it also provides an exit opportunity to minority shareholders in the event of a change in control of the target. This is to protect them against behaviour of the new acquirer that may be potentially abusive to the interests of the minority who may then lack favourable exit opportunities.³¹ On the other hand, the MBR has been met with strong criticism on the ground that it acts as an impediment to otherwise value-enhancing takeovers as it may provide a form of protection for controlling shareholders.³² The increased cost of making a mandatory offer could deter acquirers from seeking control over a company,³³ thereby impeding the market for corporate control.

Of greater importance to my analysis is that the MBR operates with different outcomes in companies with diffused shareholding and those with concentrated shareholding. In a concentrated shareholding structure, the MBR is likely to favour the controlling shareholder as against the interest of either an acquirer intending to obtain control over the company or the minority shareholders who wish to exit on equal terms.³⁴ This would be seen as objectionable in countries where substantial shareholding is held by business families or the state, who may rely upon the MBR to perpetuate their position in the company.³⁵ Furthermore, it has been argued that in companies with concentrated

²⁹ This is also evident from the track record of mandatory offers in India over the last three years as indicated in Tables 2 and 3 above.

³⁰ R. Luttmann, 'Changes of Corporate Control and Mandatory Bids', *International Review of Law and Economics*, 12 (1992), 497-516, p. 498.

³¹ U. Varottil, 'Comparative Takeover Regulation and the Concept of 'Control'', *Singapore Journal of Legal Studies*, [2012], 208-31.

³² For a discussion of this literature, see Xi, 'The Political Economy of Takeover Regulation', p. 158, Kraakman, *The Anatomy of Corporate Law*, p. 254.

³³ Luttmann, 'Changes of Corporate Control and Mandatory Bids'.

³⁴ Kraakman, *The Anatomy of Corporate Law*, p. 258.

³⁵ *Ibid*, p. 259.

shareholding, the MBR is likely to reinforce the concentration rather than to bring about diffusion in shareholding.³⁶

In this theoretical backdrop, I argue in the remainder of this Part that given the concentration of shareholding in companies, India's strong emphasis on the MBR as the core of its takeover regulation operates as an impediment to value-enhancing control shifts, enables promoters to entrench themselves further in their companies, and thereby limits the market for corporate control. Certain specific facets of MBR in the Indian context exacerbate the situation as they make the rule far more stringent than in other jurisdictions.

1. *Triggers for the MBR*

The 2011 Code prescribes three different methods by which an acquirer may trigger the MBR. The first is an initial voting percentage threshold, which is attracted when the acquirer obtains shares or voting rights such that it is able to exercise 25% or more voting rights in the target.³⁷ The second threshold applies to incumbents who are already holding between 25% and 75% shares in the company. They would trigger the MBR if they acquire an additional 5% or more voting rights during each financial year.³⁸ The final trigger applies when an acquirer acquires 'control' over the target irrespective of acquiring shares or voting rights in the target.³⁹ The scope of the MBR in India is expansive as it also covers indirect acquisitions, whether they occur in India or in other jurisdictions, so long as they result in a control shift in an Indian listed company.⁴⁰

The initial threshold is a crucial one as that is triggered when a rank outsider wishes to take over the target, an aspect that is most relatable to the market for corporate control.⁴¹ Hence, the determination of the percentage limit ought to be a meticulous exercise. While a high percentage threshold for triggering the MBR would fail to provide the full benefit of the equal treatment rule to the minority shareholders as it would let several control changes to fall under the radar, a low percentage would have the converse effect by unduly triggering the MBR and thereby impeding control changes.

³⁶ Wan demonstrates in the case of Singapore that despite the existence of the MBR since 1974, empirical data shows further concentration of shareholdings in that jurisdiction, although it is hard to find a direct causal relationship. Wan W.Y., 'Legal Transplantation of UK-Style Takeover Regulation in Singapore', Paper for Conference on Comparative Takeover Regulation (July 2015), pp. 35-36.

³⁷ 2011 Code, reg. 3(1).

³⁸ *Ibid*, reg. 3(2).

³⁹ *Ibid*, reg. 4.

⁴⁰ Kraakman, *The Anatomy of Corporate Law*, p. 259 (observing that the "adverse impact of the [MBR] is further enhanced if it applies to indirect acquisitions of control").

⁴¹ The second and third triggers are discussed in Parts IV.1 and III.2 respectively below.

Rather than viewing the threshold in absolute terms, it would be necessary to examine it contextually taking into account the shareholding pattern of the relevant jurisdiction and whether the MBR threshold bears any correlation with such shareholding pattern. In pegging the quantitative MBR threshold, the natural proposition would be that where shareholding is dispersed the threshold must be lower, and where shareholding is concentrated it must be higher.⁴² Given the concentrated shareholding structure of Indian companies, it would be logical for India's regulation to set a high threshold. But, that has not been the case.

SEBI has not only historically set low thresholds for the MBR trigger, but it has grappled with finding the appropriate limit. The limit has fluctuated between 10% and 25%, arguably low in the context of concentrated shareholdings in Indian companies. The 1994 Code set the threshold at 10% voting rights. This was increased to 15% in 1998. It was only TRAC that decided to substantially revisit the issue of the initial threshold. After conducting a detailed study of shareholding patterns in Indian companies, TRAC decided to fix the initial trigger at 25% voting rights, which was accepted by SEBI and incorporated in the 2011 Code.

While the increase in the limit to 25% signifies SEBI's intention to promote the market for corporate control by providing acquirers with additional headroom to increase their stake in the company up to that higher limit without triggering the MBR, arguably that limit is still inadequate. The average shareholdings in Indian companies⁴³ show that the limit is far less than average shareholdings whereby promoters may prevent changes in control, with the MBR coming to their aid. Contrast this with most other jurisdictions where the MBR limit tends to be in the range of 30-35%.⁴⁴ This not only includes those with concentrated shareholdings such as Singapore, but also those with dispersed shareholding such as the UK. While the present MBR threshold is more in tune with the concentrated shareholding structure in India as compared to the previous 15% threshold, it is arguably still low given the level of concentration as well as the international experience.

⁴² M. Ventoruzzo, 'Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends, *Texas International Law Journal*, 41 (2006), 171-221, p. 197.

⁴³ See the shareholding data in Table 5 below.

⁴⁴ Varottil, 'Comparative Takeover Regulation and the Concept of 'Control'', pp. 215-6, 231.

2. *The Qualitative MBR Trigger*

Under Indian takeover regulation, it is possible to trigger the MBR even without acquiring shares or voting rights, which aggravates the severity of the rule for acquirers. This occurs when the acquirer directly or indirectly acquires *control* over the target.⁴⁵ It has been the subject matter of considerable controversy in India as it has attracted significant attention of the regulator and the courts.⁴⁶ The expression 'control' is defined quite widely to include:

“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”.⁴⁷

This definition encompasses both control over the board of directors of the company, as well as other forms of management or operation control of its business or strategic policy. Board control could potentially arise when an acquirer obtains substantial shareholding in the target, which is below the initial threshold (25% voting rights), but where the acquirer is the single largest shareholder.

The Securities Appellate Tribunal (SAT)⁴⁸ has had the opportunity to consider the position of an acquirer who obtained a significant shareholding constituting marginally below the MBR threshold without any additional contractual rights. In one case,⁴⁹ the SAT elucidated the rationale for the subjective definition of control and reiterated that the open ended definition of control in the Takeover Regulations was understandable as it is a 'term of wide connotation and amplitude'⁵⁰ having regard to the object and scheme of takeover regulation in India. The philosophy of the Takeover Regulations as interpreted by the SAT gives SEBI considerable leeway to invoke the MBR against acquirers who may have acquired voting rights that are less than the initial threshold.

⁴⁵ 2011 Code, reg. 4.

⁴⁶ For a more detailed discussion on this issue, see Varottil, 'Comparative Takeover Regulation and the Concept of 'Control'', pp. 221-7.

⁴⁷ 2011 Code, reg. 2(e).

⁴⁸ The SAT hears appeals against the orders of SEBI on matters involving securities regulation, including takeovers. Securities and Exchange Board of India Act, 1992, s. 15-T.

⁴⁹ *Ashwin K Doshi v. Securities and Exchange Board of India* (25 October 2002) (available at <http://www.sebi.gov.in/satorders/ashwin.html>).

⁵⁰ *Ashwin K Doshi*, para. 155.

Moving to management control, it typically arises when the acquirer obtains a significant shareholding in the target, but at the same time there is another shareholder or group (such as an existing promoter) that holds a substantial shareholding in the target. This could amount to joint control. It has been the pattern in India in such cases that the acquirer (who is either a strategic or financial investor) seeks additional protective rights by way of contract with the promoter, including board representation, quorum rights and veto rights. More importantly, it is almost never the intention of the investor (especially one whose investment is financial in nature) to seek any control over the company. Despite the well-established global practice of substantial investors seeking protective rights, SEBI has been steadfast in its insistence that these rights confer upon the investors 'control' over the target. Regardless of strong resistance and protestations from the investing community and their advisors, SEBI has been unwilling to budge from its stance. Investors have therefore sought legal remedies before appellate fora. Although the issue has been deliberated and dealt with extensively before the authorities, a conclusive resolution to the issue has been elusive, as examined below.

In *Subhkam Ventures v. Securities and Exchange Board of India*,⁵¹ the SAT was concerned with the typical case where a financial investor took up a 19.91% stake in the target. The SAT closely analysed the contractual arrangements between the parties. It concluded that the investor's right to nominate one among several directors on the board of the target did not confer upon it any control.⁵² Similarly, that the investor has affirmative or veto rights whereby the approval of the investor is required for the target to undertake several actions was insufficient to constitute control.⁵³ These rights were in the form of protective provisions to safeguard the investment and therefore do not confer any control on the investor. This decision provided considerable relief to the investing community in India, who were able to successfully advocate their position seeking a narrow definition of control.⁵⁴ But, the euphoria was short-lived, as SEBI preferred an appeal to the Supreme Court of India. Although a ruling from the highest court was expected with great anticipation, that was not to be as the parties settled during the pendency of the appeal. An added disappointment arose when the Supreme

⁵¹ SAT Order, 15 January 2010 (available at <http://www.sebi.gov.in/satorders/subhkamventures.pdf>).

⁵² *Ibid*, para. 7.

⁵³ *Ibid*, para. 8.

⁵⁴ See U. Varottil, 'Relief for Investor Community on 'Control' Debate', *IndiaCorpLaw Blog* (17 January 2010).

Court clarified that the order of SAT will not be treated as precedent and that the question of law was being kept open.⁵⁵

In all, SEBI continues to have the leeway to exercise a subjective determination of control, which it does in fact exercise quite widely, and the concept of 'control' continues to complicate matters under the Indian legal regime, particularly with respect to the MBR. Since potential acquirers in targets may be foisted with the MBR even though they stay beneath the initial quantitative threshold, this will have a chilling effect on takeovers and the market for corporate control.

3. *Other Aspects of MBR*

The rigid features of the MBR are strengthened by a combination of other factors. Once triggered, it is hard for acquirers to rid themselves of the strict responsibilities under the MBR without attracting severe adverse consequences. I argue that these factors add to the increased costs for acquirers and hence affect the market for corporate control.

a. *The Sanctity of Offers*

SEBI's Takeover Code treats offers, once made, as sacrosanct thereby making it almost impossible for acquirers to wriggle out of their obligations. This is due to the limited nature of conditions that can be imposed on takeover offers (especially mandatory offers) and strict rules regarding withdrawal of offers.

The 1997 Code provided for three circumstances when an acquirer could withdraw an offer. These were (a) when statutory approvals required have been refused; (b) when the sole acquirer, being a natural person, has died; and (c) in such circumstances as in SEBI's opinion merit withdrawal.⁵⁶ This indicates that bespoke protective conditions such as the 'material adverse change' (MAC) condition and financing condition that are common in the developed markets⁵⁷ are unavailable in India. Nevertheless, acquirers have sought to invoke the general power of SEBI in item (c) above to seek withdrawal in

⁵⁵ *Securities and Exchange Board of India v. Subhkam Ventures (I) Private Limited* MANU/SC/1587/2011.

⁵⁶ 1997 Code, reg. 27(1).

⁵⁷ See Wan and Varottil, *Mergers and Acquisitions in Singapore*, pp. 171-190 (discussing the position in the UK, the US, Australia and Singapore); Wan WY, 'Invoking Protective Conditions to Terminate Public Mergers and Acquisitions Transactions', *Journal of Business Law*, [2011], 64-90.

extraordinary circumstances and have appealed all the way to the Supreme Court of India, but without success.

In *Nirma Industries v. Securities and Exchange Board of India*,⁵⁸ Nirma (the acquirer) made a mandatory offer for the shares of Shree Rama Multitech Limited (target) when it enforced a pledge of shares offered by the company's promoters. During the course of the offer, Nirma became aware of a financial fraud in the target that was not discovered during the due diligence it conducted prior to the offer. On the acquirer's request, SEBI refused to permit a withdrawal of the offer on that ground. The Supreme Court agreed with SEBI's approach on a technical interpretation of the 1997 Regulations.⁵⁹ In a subsequent case, the Court extended the same principle to voluntary offers as well. In *Securities and Exchange Board of India v. Akshya Infrastructure Pvt. Ltd.*,⁶⁰ Akshya (which is part of the target's promoter group) made a voluntary offer for the shares of MARG (target). However, when the acquirer filed the draft letter of offer with SEBI, some discussions ensued and the offer was delayed by 13 months, by which time the offer became unviable. Neither SEBI nor SAT permitted a withdrawal of the offer. Upon appeal, the Supreme Court concurred on the ground that on matters of withdrawal there is no distinction between a mandatory offer and a voluntary offer. More importantly, while the Supreme Court expressed strong concern regarding SEBI's delay in clearing the offer, it held that the delay on SEBI's part was insufficient to merit a withdrawal of the offer. Given the sanctification of this principle by the Supreme Court, it has begun to hold sway. For example, in a more recent case,⁶¹ the SAT was constrained by the Supreme Court rulings and refused to permit a withdrawal of an offer even where there was a two-year delay in obtaining SEBI's approval of the offer and in the meanwhile the target's promoters were alleged to have encumbered the most valuable asset of the company and siphoned its funds.

The position under the 2011 Code has altered only marginally. A new ground has been added whereby the acquirer can withdraw an offer if a condition that has been included in the agreement that triggers the offer is not met for reasons beyond the reasonable

⁵⁸ (2013) 8 SCC 20.

⁵⁹ In interpreting the three scenarios in regulation 27 of the 1997 Regulations (see text accompanying n. 56 above), the court applied the principle of *ejusdem generis* in statutory interpretation whereby when specific entries in a list constitute a class and are followed by a general word, the general word is also limited in scope to that class. Hence the expression "such circumstances" in item (c) ought to be interpreted in a limited manner consistent with the scope of the preceding specific situations. For a critique of this approach, see S. Vayttaden, 'A Socialist Agenda for Indian Securities Law', *The Firm: Corporate Law in India* (23 May 2013).

⁶⁰ AIR 2014 SC 1963.

⁶¹ *Pramod Jain v. Securities and Exchange Board of India*, MANU/SB/0050/2014.

control of the acquirer so long as those conditions are specifically disclosed in the offer.⁶² While this enhances the ability of acquirers to design conditions (such as the MAC clause) in a mandatory offer, the result is that both the offer as well as the private arrangement (that triggered the offer) would fail if the condition were not satisfied. Hence, while some leeway has been provided for mandatory offers, the benefit will not be available to voluntary offers that would be subject to the strict regime outlined by the Supreme Court.

b. Penalties; Nature of Regulation

In India, the consequences of breaching the obligations under the Takeover Regulations are stringent. Under the Regulations, SEBI possesses extensive powers, including to direct an acquirer who has breached them to disinvest shares, not to exercise voting rights, and even to make a takeover offer.⁶³ More importantly, an acquirer who violates the Takeover Regulations could attract a civil penalty of up between Rs. 1 million and Rs. 250 million or three times the amount of profits made out of a failure to comply with the Takeover Regulations, whichever is higher.⁶⁴ In addition, a non-compliant acquirer could also be susceptible to criminal prosecution.⁶⁵ Hence, compared to jurisdictions such as the UK and Singapore, the approach in India has been to ensure compliance with the Takeover Regulations by means of strict penalties.⁶⁶ Not only do the Takeover Regulations constitute subsidiary legislation, which obtains its statutory basis from the SEBI Act, but also SEBI itself is a statutory body with significant powers to issue directions, impose monetary penalties and initiate criminal prosecution.

Moving to enforcement and adjudication, unlike the UK and Singapore which have formed takeover panels to resolve disputes in the interests of speed and efficiency and to avoid tactical litigation,⁶⁷ India has followed the system of enforcement by the securities regulator, which is then subject to a lengthy appeals process. At the initial stage, SEBI conducts investigations in respect of potential violations of takeover regulations. If an order is passed against an acquirer (or other party), such person is

⁶² 2011 Code, reg. 23(1)(c).

⁶³ 2011 Code, reg. 32.

⁶⁴ Securities and Exchange Board of India Act, 1992, s. 15H.

⁶⁵ *Ibid.*, s. 24 (with the punishment being a maximum imprisonment of ten years or with a maximum fine of Rs. 250 million or both).

⁶⁶ K. Shorewala and V. Vasumitra, 'Comparing Takeover Laws in UK, India & Singapore' (available at <http://ssrn.com/abstract=1753341>), p. 14.

⁶⁷ *Ibid.*, p. 29.

entitled to appeal to the SAT.⁶⁸ An appeal from SAT's order lies to the Supreme Court.⁶⁹ The enforcement and adjudication hence occurs through a specific regime established for the purpose. While this makes the resolution of disputes in this area of the law more efficient and less costly compared to India's normal court system (which suffers from acute backlogs), this alternative adjudicatory system has been subject to its own set of delays and inefficiencies.⁷⁰

The fact that acquirers may not only face harsh consequences for non-compliance with the MBR and other requirements under the Takeover Regulations, but that they may be subjected to extended litigation and several levels of appeals before the Indian regulators and the Supreme Court add to the rigidity and negative consequences of the MBR and therefore to a dilutive effect on the market for corporate control.

4. *The Curious Case of Partial Offers*

While I have thus far argued that the MBR and its various facets are unduly stringent for acquirers, one specific aspect of India's MBR has a dilutive effect on its full-fledged operation. The Takeover Code has historically required an acquirer who triggers the MBR to make only a partial offer and not to acquire all the remaining shares in the company. Such partial offers are generally frowned upon, as they do not secure exit and equal treatment to the minority shareholders to the fullest extent.⁷¹ Hence, a number of leading jurisdictions require an acquirer to make an offer for all remaining shares in the company.⁷² Although India has made an exception in this regard, and thereby made the MBR less onerous on acquirers, the rationale for the approach is dictated by interest group dynamics, which emerge quite clearly, and not with a view to facilitating the market for corporate control in general.

Under the 1994 Code, acquirers who triggered the MBR were required to make an offer for a minimum size of 20% shares in the target, accepted on a proportionate basis in case of excess tendering by shareholders. The policy tensions on this count became quite evident as early as 1997 when the Code came up for review. The Bhagwati

⁶⁸ Securities and Exchange Board of India Act, 1992, s. 15H. In such cases, the jurisdiction of civil courts is barred. *Ibid.*, ss. 15Y, 20A. See also, *Kesha Appliances P. Ltd. v. Royal Holdings Services Ltd.*, [2006] 130 Comp. Cas. 227 (Bom.)

⁶⁹ Securities and Exchange Board of India Act, 1992, s. 15H.

⁷⁰ One example is SEBI's delays in case of withdrawal requests discussed in text accompanying nn. 60-61 above.

⁷¹ See Kraakman, *The Anatomy of Corporate Law*, pp. 253-4.

⁷² Wan and Varottil, *Mergers and Acquisitions in Singapore*, p. 512-9 (for a discussion of Singapore and the UK).

Committee was evidently torn between granting full exit to public shareholders (as was the practice in jurisdictions such as the UK) and arriving at a practical solution keeping in mind the ground realities.⁷³ In the end, in deciding to retain partial offers for 20%, it opted for pragmatism over equal treatment to minority shareholders. The underlying reason relates to the methods of financing takeovers in India. While in developed markets, takeovers are principally financed by banks, such a method is unavailable in India due to restrictions imposed by its central bank, the Reserve Bank of India (RBI). This would affect financing of takeovers in India, but would not apply to financing obtained overseas. For this reason, according to the Committee “there would no level playing ground between Indian companies and foreign companies who would always be at an advantage if the requirement of a full offer is introduced”.⁷⁴ In other words, Indian acquirers would be at a disadvantage in raising the required finances if they are to make a full offer, while foreign acquirers suffer from no such limitations. As evident, the approach in Indian takeover regulation has been to placate domestic business interests that were evidently feeling the threat of potential takeovers by foreign companies. The interests of domestic industry prevailed in the regulatory process.⁷⁵

The issue was revisited in 2011 during TRAC’s review of the Takeover Regulations. TRAC adopted a different approach. While it was mindful of the lack of bank financing for Indian acquirers, it felt that a partial offer regime gave rise to inequities whereby the promoters would get full exit as opposed to public shareholders who only receive partial exit. Hence, it concluded “there is a very strong case for allowing all public shareholders to obtain a complete exit whenever an open offer is made”.⁷⁶ TRAC gave precedence to the principle of equal treatment to the fullest extent rather than to adopt a pragmatic approach. However, SEBI refused to accept TRAC’s recommendations on this count. It appears to have taken cognisance of the disparities in financing between Indian and foreign acquirers, and sought to create a level playing field between the two.⁷⁷ Instead, it increased the offer size from the previous 20% to 26%. This is consistent with the MBR threshold of 25%, as any acquirer that triggers the MBR would have to make an offer for an additional 26% such that the acquirer could obtain majority control over the company if the offer is successful.

⁷³ Bhagwati Report 1997, para. 6.12.

⁷⁴ *Ibid.*

⁷⁵ This position remain unchanged when the Takeover Regulations were reviewed subsequently. See Bhagwati Report 2002, para. 5.

⁷⁶ TRAC Report, para. 1.12 [emphasis in original].

⁷⁷ K. Talwar and N. Saksena, ‘Anti-Acquirer and Pro-Shareholder? An Analysis of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, *NUJS Law Review*, 5 (2012), 129-42, pp. 136-7.

Although partial offers in India dilute the otherwise rigorous effect of the MBR, the reason for the compromise is to protect Indian industry from takeovers by foreign acquirers. In that sense, by preferring one type of acquirer to the other, India's takeover regulation operates to weaken the market for corporate control. Interest group politics best explain this phenomenon. While the Bhagwati Committee was explicit in its approach in favouring Indian acquirers, SEBI has done so implicitly in the 2011 Regulations by refusing to accept TRAC's recommendation on the issue.

In concluding this Part, we find that the MBR is a prominent aspect of Indian takeover regulation, due to which most offers in India (94%) are mandatory offers. This is understandably due to the stringent nature of the MBR, which include a combination of a quantitative threshold (of 25% voting rights) as well as qualitative aspect of "control". At the same time, by triggering the MBR, acquirers have little wiggle room to manoeuvre around the offer and to include conditions that are customary in other leading jurisdictions. The only tempering aspect of the MBR is the ability to make a partial offer, which too is designed to benefit Indian acquirers as well as incumbents. This mélange of factors considerably impedes a market for corporate control, and hence benefits incumbents.

IV. Additional Features of Incumbency

A stringent MBR would ensure that control shifts are accompanied by an exit mechanism and equal treatment for public shareholders. However, due to certain special features of SEBI's Takeover Code as well as the manner in which it is implemented, public shareholders are not in a position to enjoy the requisite benefits. On the contrary, incumbents are able to limit the market for corporate control due to specific benefits they possess under the Takeover Code and other statutory provisions, which I explore in this Part.

1. Creeping Acquisition

Since 1997, the Takeover Code has permitted incumbents who hold de facto control of the target to consolidate such control on a gradual basis without triggering the MBR. Under the 1997 Code, persons holding between 10% (the then MBR trigger) and 75% were allowed to acquire up to 2% additional voting rights during any period of twelve

months.⁷⁸ The rationale for this was that the Bhagwati Committee “appreciated the fact that in a competitive environment, it may become necessary for person(s) in control of the company to consolidate their holdings either suo moto or to build their defences against takeover threats”.⁷⁹ This incumbent friendly measure has been altered over the years, sometimes excessively in favour of the promoters. In 1998, SEBI increased the creeping acquisition limit to 5% per year and thereafter in 2001 to 10% per year.⁸⁰ Both SEBI and the Bhagwati Committee appear to be concerned about the need to protect Indian industry from challenges in the business environment perhaps as a result of lobbying from Indian business interests.⁸¹ However, in 2002 the creeping acquisition limit was reduced to 5% per year, a limit that has remained to date.⁸² Under the 2011 Code, any person holding between 25% and 75% shares in the company is entitled to acquire up to 5% voting rights during each financial year without triggering the MBR. There is sufficient evidence to indicate the widespread use of the creeping acquisition mechanisms by promoters of Indian companies, including to stave off potential hostile takeovers.⁸³

The generous creeping acquisition limits and its extensive use create a significant distortion in the market for corporate control in India. Incumbents are able to gradually shore up their holdings without triggering the MBR, thereby depriving the public shareholders of the equal treatment that is the stated philosophy of takeover regulation. At the same time, the creeping acquisition mechanism unduly favours the incumbents against the outside acquirers such as hostile bidders. While incumbents obtain headroom for acquisitions without triggering costly obligations under the MBR, outside acquirers enjoy no such ability. The need to trigger the MBR when they cross the initial threshold coupled with the fact that incumbents may put up a defence by building up their stake without the costly mandatory offer requirement would trigger outside acquirers from challenging the control enjoyed by the incumbents. This severely hampers the market for corporate control.

2. Acquirer's Disclosure Requirements

⁷⁸ 1997 Code, reg. 11(1).

⁷⁹ Bhagwati Report, 1997, para. 6.2.

⁸⁰ J. Banaji, “Thwarting the market for corporate control: takeover regulation in India”, (2005) (available at http://eprints.soas.ac.uk/10920/1/QEH_banaji.pdf), p. 5.

⁸¹ *Ibid.* Bhagwati Report, 2002, para. 3.2.

⁸² Even latest review of the Takeover Regulations “underscored the fact that the creeping acquisition route is meant to facilitate consolidation by persons already in control or holding substantial number of shares”. TRAC Report, para. 2.16.

⁸³ S. Mathew, ‘Hostile Takeovers in India: New Prospects, Challenges, and Regulatory Opportunities’, *Columbia Business Law Review*, [2007], 800-43, pp. 807-8.

The protection enjoyed by the incumbents under the creeping acquisition route is enhanced by early warning mechanisms embedded in the Takeover Code. When any acquirer acquires 5% or more shares or voting rights in a target, such acquirer is required to disclose such acquisition to the target as well as to the stock exchange where the securities are listed.⁸⁴ Such disclosure is required to be made within two working days of the acquisition.⁸⁵ Such a time-bound disclosure requirement operates in favour of the incumbents who obtain signals regarding a potential threat to their control over the target, which allows them to immediately take measures to increase their shareholding, including by using the creeping acquisition route.

Similarly, a shareholder who holds more than 5% shares is required to disclose purchases or sales of 2% shares or voting rights in the aggregate since the previous disclosure.⁸⁶ This too helps the incumbents follow the strategy of a potential outside acquirer and devise their own plan to defend a potential takeover. Hence, the creeping acquisition and early warning mechanism operate in tandem to provide sufficient cushion to the incumbents.

3. *Exemptions from the MBR*

The Takeover Regulations exempt a number of transactions from the MBR. In such cases, the minorities are unable to enjoy equal treatment by exercising exit rights. Here, countervailing factors must be taken into account. While promoters may be required to engage in corporate restructuring to rearrange their holdings that may be beneficial in nature, such restructurings ought not to deprive minority shareholders of their rights.⁸⁷ Rather than prohibit such rearrangements altogether, the Takeover Code has devised a set of exemptions on the basis of conditions that seek to achieve an appropriate balance. These exemptions have been narrowed over a period of time, and have been streamlined further in the 2011 Code. Nevertheless, the manner in which acquirers have utilised the exemptions suggest that they have defied the purpose of takeover regulation in structuring a market for corporate control.⁸⁸

Under the previous versions of the Takeover Code, exemptions were granted for transfers inter se among promoters, between parent companies and their subsidiaries, and among group companies. Alterations of shareholdings among members of a group

⁸⁴ 2011 Code, reg. 29(1),(3).

⁸⁵ *Ibid.*

⁸⁶ 2011 Code, reg. 29(2).

⁸⁷ Nishith Desai Associates, 'Public M&As in India', p. 26.

⁸⁸ Banaji, 'Thwarting the market for corporate control', p. 5.

were generally exempt. Similarly, acquisitions by market participants in the ordinary course of business were exempt. More importantly, issue of shares by the company to specific investors by way of preferential allotment was also exempt.⁸⁹ Over time, the first two types of exemptions have been narrowed and streamlined, and the preferential allotment exemption has been eliminated.⁹⁰

The 2011 Code has now categorised the exemptions.⁹¹ Most exemptions apply when the acquisition amounts to a change in control of management. Others apply only to substantial acquisition of shares or consolidation of shareholding. These are automatic exemptions that can be availed of by the acquirers after making the necessary disclosures. For example, transfers of shares between promoters are exempt so long as such persons are disclosed as promoters in the shareholding pattern filed by the companies with the stock exchanges. In case the automatic exemptions are not available (including because the conditions stipulated are not satisfied in a given case), it is open to the acquirer to approach SEBI for a specific exemption. SEBI will consider such applications on a case-by-case basis.

An empirical examination indicates that acquirers have been successful in extensively relying upon exemptions, and in avoiding the MBR. Table 4 compares the number of takeover offers made and the number of automatic exemptions availed of by acquirers during a fourteen-year period from 1997-98 to 2010-11.⁹²

⁸⁹ The idea here is that the company is issuing shares to the acquirer, and that the transaction will have to be approved by the shareholders, effectively amounting to a whitewash.

⁹⁰ Banaji, 'Thwarting the market for corporate control', p. 5.

⁹¹ 1997 Regulations, reg. 10.

⁹² SEBI has not published the exemption data for the period commencing the year 2011-12, and hence a comparison is not possible for that period.

Table 4
Open Offers and Exempted Acquisitions

Year	Open Offers		Automatic Exemptions	
	No.	Amount	No.	Amount
1997-98	40	578	93	3,502
1998-99	66	1,014	201	1,888
1999-00	75	461	252	4,677
2000-01	77	1,372	248	4,873
2001-02	81	3,610	276	2,539
2002-03	88	6,389	238	2,428
2003-04	65	1,595	171	1,436
2004-05	61	4,632	212	6,958
2005-06	102	4,080	245	17,132
2006-07	87	11,352	223	18,608
2007-08	114	28,706	232	6,458
2008-09	99	4,711	227	10,502
2009-10	76	5,857	243	15,331
2010-11	102	19,298	410	28,042
Aggregate for the period	1,133	93,655	3,271	1,24,374

Table 4 indicates the extensive use of exemptions, far in excess of offers made by acquirers. Only 26% of acquisitions went through the takeover offer route. The remaining 74% were carried out by availing of exemptions. Even in terms of amounts, the offers constituted only 43%, while exemptions constituted 57%. While there seems to be some balance in the amounts between offers and exemptions, there is considerable disparity in the numbers of transactions. A year-wise analysis of offers and exemptions further clarify the picture.

Figure 3
Year-wise Analysis of Number of Offers and Automatic Exemptions

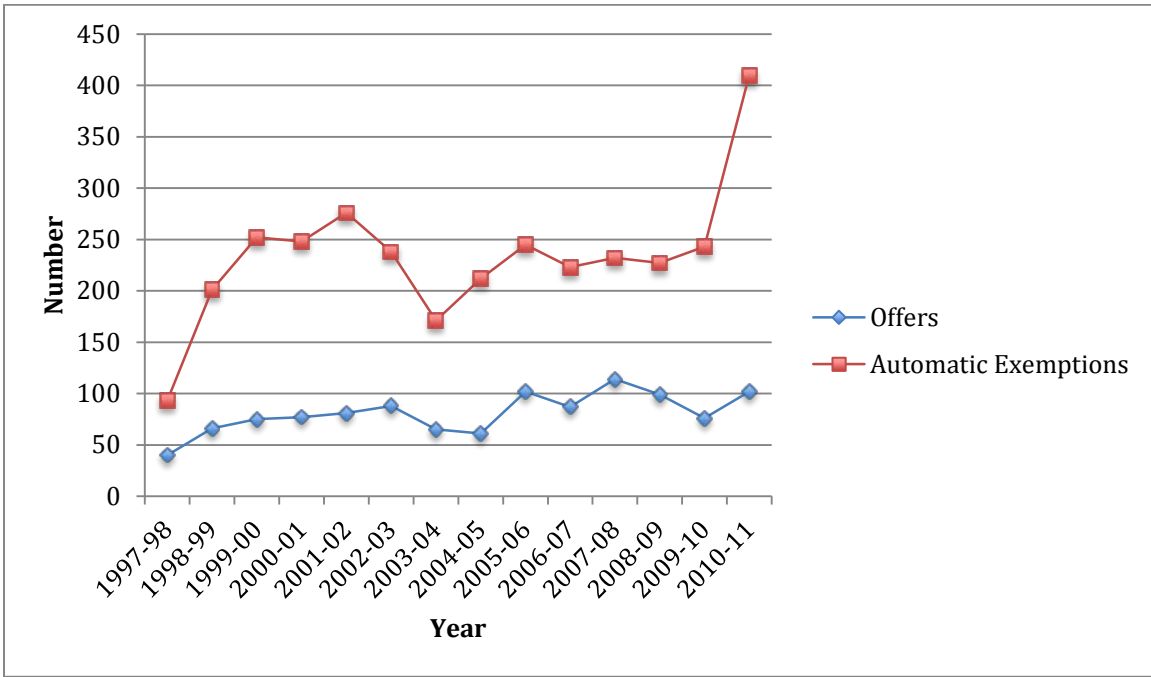


Figure 3 shows that the automatic exemptions are consistently more than the number of offers made each year, with a considerable upsurge in the year 2010-11.

Figure 4
Year-wise Analysis in Amounts of Offers and Automatic Exemptions

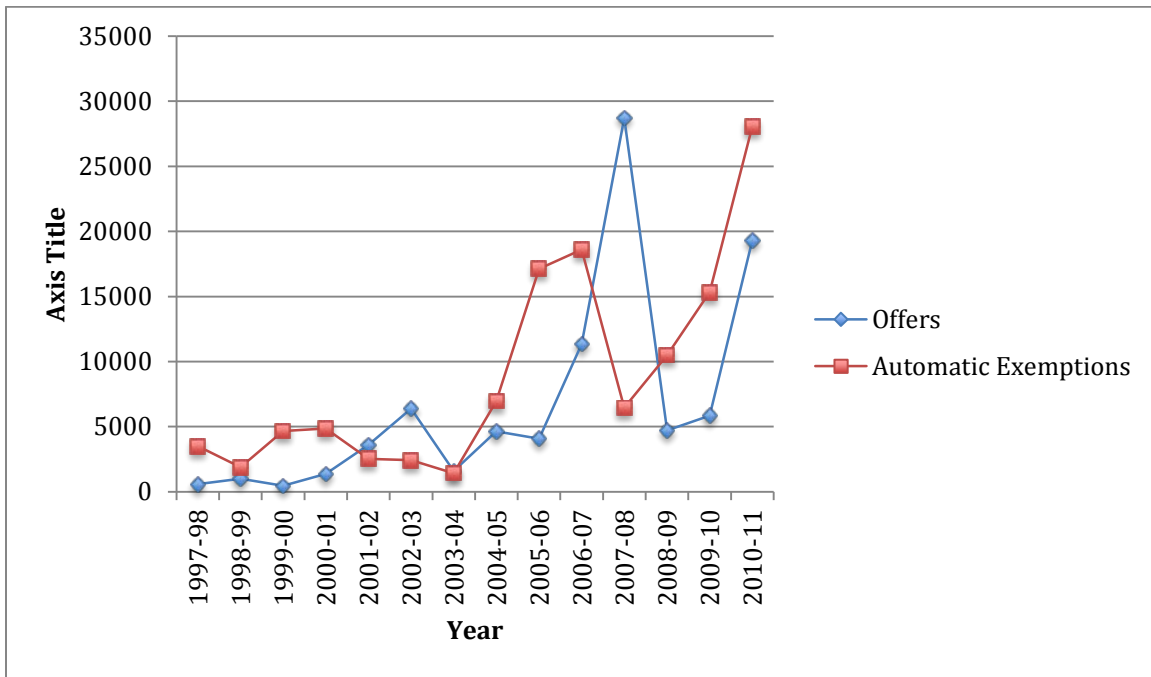


Figure 4 shows a more mixed relationship between takeover offer and exemptions when compared by volumes. In some years offer sizes have been higher than exemptions, although more recently there seems to be a perceptible upward trend in the size of exemptions as well, consistent with the spike in numbers.

The availability and use of exemptions of sizeable magnitude indicates that a number of transactions are undertaken without triggering the MBR. This results in the absence of exit options to the public shareholders, thereby raising doubts about compliance with the equal treatment principle that is enshrined in the Takeover Regulations. More importantly, while incumbents are entitled to rearrange their shareholders and garner their positions to defend themselves, outside acquirers cannot avail of similar exemptions and would have to acquire control through the costly mandatory offer process. Here again, it is evident that the exemption mechanism is intended to benefit the incumbents against possible outside acquirers. This in turn thwarts a market for corporate control.

In concluding this Part, we find that promoters in Indian companies enjoy certain benefits that are not available to outside acquirers. This reinforces the promoters' sheltered position under Indian law.

V. Hostile Takeovers: How Realistic Are They?

Although I have argued that the Takeover Code in India favours consolidation of control by incumbents, intriguingly though it does not provide significant defensive mechanisms to targets or their promoters. Hence, the question arises whether there is (or could be) an active market for hostile takeovers. In this Part, I examine the market for hostile takeovers in India, and the extent to which that operates to benefit public shareholders.

Compared to the size of the Indian capital markets and the number of listed companies, there have been only a handful of hostile or contested takeovers.⁹³ Barring one known exception, they have not been successful.⁹⁴ This is despite limited powers available to the targets' board to prevent hostile takeovers. Hence, the outcome must be attributable to factors such as concentration of shareholding in Indian companies and other factors.

1. Defences Under Indian Law

The Takeover Code has stayed loyal to the “no-frustration” rule that is consistent with jurisdictions such as the UK and Singapore whereby the target’s board has weak powers to intervene in a takeover. Hence, where a takeover offer is either announced or becomes mandated the board of the target is prohibited from taking any frustrating actions without the approval of the shareholders by way of a special resolution through postal ballot.⁹⁵ Due to this, the defence mechanisms that are customary in jurisdictions such as the US (Delaware) are unavailable in India.

Added to this is the influence of corporate law in general. For example, poison pills through the issue of convertible instruments to shareholders at a substantial discount are not available in India because Indian listed companies not only require shareholder approval for the issue of such instruments (which approval is valid only for a specified period of time), but they cannot be issued at a price below the prevailing market price

⁹³ For a discussion of these hostile takeovers, see Mathew, ‘Hostile Takeovers in India’, pp. 811-814; A. Chandrachud, ‘The Emerging Market for Corporate Control in India: Assessing (and Devising) Shark Repellents for India’s Regulatory Environment’, *Washington University Global Studies Law Review*, 10 (2011), 187-238, pp. 190-1.

⁹⁴ C. Shroff, ‘You need a defence strategy’, *International Financial Law Review*, July 2008, 40-1, p. 40.

⁹⁵ 2011 Code, reg. 26(2). A special resolution requires a 75% majority of shareholders who have exercised their votes. The postal ballot requirement is intended to generate higher participation rates among shareholders.

computed on a historic basis for a period prior to the date of issue.⁹⁶ Similarly, while a staggered board can be established in India—as is common practice—it does not carry any utility as a takeover defence mechanism as it does in Delaware. This is because directors can simply be removed without “cause” by a simple majority of shareholders voting,⁹⁷ which makes the board vulnerable to the actions of hostile acquirers. Scorched earth tactics such as destroying value in the company by selling its important assets will not work in India. Not only is shareholder approval required for such a transaction,⁹⁸ but SEBI may not take kindly to these efforts as they are likely to destroy value for shareholders.⁹⁹

The main defence permissible under the Takeover Regulations is the white knight, which has been successfully used in India.¹⁰⁰ The regulatory stance on white knights is understandable, as it does not permit the target’s board to prevent a takeover, but to generate options for shareholders to choose among competing bidders thereby leaving the ultimate decision to the shareholders. Other defensive mechanisms used include embedded defences. For example, the articles of association of the target could confer promoters with rights that guarantee lifetime chairmanship or the right to nominate a certain number of directors.¹⁰¹ Alternatively, contracts of the target could contain “change of control” provisions that are triggered to reduce the value of the target. A commonly discussed instance is the use of a “brand pill” whereby the Tata group of companies ensures that an acquisition of control of one of the companies by an outside acquirer will disentitle the target from using the brand name.¹⁰² Therefore, apart from the white knight or embedded defences that are established in advance, takeover defences are not permissible under Indian takeover regulation. Why then are hostile takeovers so rare in India? In order to ascertain this, I explore some of the institutional and environmental factors at play.

Hostile takeovers are incompatible with regimes where shareholding tends to be concentrated. Although institutional shareholders are becoming more activist in nature in India, the country has not witnessed the type of activism evident in other developed

⁹⁶ These restrictions are imposed under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

⁹⁷ Companies Act, 2013, s. 169(1).

⁹⁸ *Ibid*, s. 180(1).

⁹⁹ Shroff, ‘You need a defence strategy’, p. 41.

¹⁰⁰ Mathew, ‘Hostile Takeovers in India’, p. 814.

¹⁰¹ Shroff, ‘You need a defence strategy’, p. 41.

¹⁰² Mathew, ‘Hostile Takeovers in India’, p. 814.

markets.¹⁰³ Hence, it is not clear whether institutional investors are likely to side with an acquirer or the incumbents in the case of a contest for control.¹⁰⁴ Hostile takeovers by foreign acquirers are more challenging. Despite considerable relaxation of foreign investment norms in India, several constraints continue to operate. In certain sensitive industries (e.g. banking, insurance, telecommunications, civil aviation), there continue to be caps on foreign investment in terms of percentage shareholdings.¹⁰⁵ Certain types of acquisitions required the approval of the Foreign Investment Promotion Board,¹⁰⁶ and very large acquisitions require the approval of the Cabinet Committee for Economic Affairs.¹⁰⁷ In other cases as well, permissions or dispensation may be required from the Reserve Bank of India for foreign exchange flows and pricing matters.¹⁰⁸ These could prove to be formidable requirements in sensitive takeovers wherein the Indian incumbents could appeal to political sentiments and nationalistic interests to stall takeovers.

This discussion indicates that while the “no frustration” rule is enshrined in the Takeover Code thereby limiting the ability of the target’s boards to fend off a hostile takeover, other factors such as shareholding concentration and the institutional and regulatory environment dampen the likelihood of a market for corporate control. That leaves us with the question whether hostile takeovers are likely to be more frequent in the future. The answer to this lies in a closer analysis of the shareholding pattern in Indian listed companies as well as the direction in which it is moving, i.e. either dispersion or further concentration.

2. *Analysing Shareholding Patterns in Indian Companies*

That shareholding concentration is the norm in India is beyond doubt. In a 2007 study, Mathew found that the average promoter stake in the top 100 companies listed on the Stock Exchange, Mumbai (also known as BSE) was 48.09%, while in the top 500 listed companies it was 49.55%.¹⁰⁹ He, however, found at least 27 among the top 100

¹⁰³ U. Varottil, ‘The Advent of Shareholder Activism in India’, *Journal on Governance*, 1 (2012), 582-628.

¹⁰⁴ Sarkar and Sarkar, *Corporate Governance in India*, p. 438.

¹⁰⁵ Department of Industrial Policy and Promotion, Government of India, *Consolidated FDI Policy* (Effective May 12, 2015) (available at http://dipp.nic.in/English/policies/FDI_Circular_2015.pdf).

¹⁰⁶ *Ibid.*, para. 5.1. This is a body comprising secretaries from various ministries under the Government of India.

¹⁰⁷ Acquisitions in excess of Rs. 3,000 crores are required to be approved by the Cabinet Committee on Economic Affairs, which is a body comprising various ministers in the Union cabinet.

¹⁰⁸ Shroff, ‘You need a defence strategy’, p. 41.

¹⁰⁹ Mathew, ‘Hostile Takeovers in India’, p. 833.

companies were susceptible to hostile takeovers.¹¹⁰ Similarly, in 2011, Chandrachud found that 107 among the top 200 BSE companies (representing 53.5%) were vulnerable to hostile acquisitions as promoters held less than 50% in those companies.¹¹¹ These studies postulate that while hostile takeovers are few and far between, they are likely to become less uncommon in the future. At the same time, a longitudinal study by Balasubramanian and Anand of shareholding patterns in Indian companies during the period 2001 to 2011 evidences that the trend is in the direction of more concentration rather than dispersion.¹¹² They find “empirical confirmation of the predominance of concentrated ownership and control in corporate India. Not only that but also the extent of such concentration over the years was increasing.”¹¹³ They find that the median holdings of promoters in the top 50 companies had risen from 42.94% in 2001 to 56.24% in 2011, and in the top 100 companies from 48.83% to 54.21%.¹¹⁴ Although a causal relationship has not been established, this is consistent with my previous analysis that aspects of Indian takeover regulation such as a stringent MBR, a generous creeping acquisition limit and liberal exemptions would likely benefit incumbents to shore up their holdings.¹¹⁵

In this Part, I test these claims in a current context by analysing the shareholding pattern of Indian companies more recently, as of 31 March 2015. Such a renewed analysis is necessary not only to ensure a more updated timeframe, but also because of intervening regulatory prescriptions that are intended to make the shareholding in India companies more dispersed. In June 2010, the Government of India prescribed that within a three-year period (i.e. by June 2013) all Indian listed companies are to maintain a public shareholding of 25%, due to which promoters could hold no more than 75%.¹¹⁶ For state-owned enterprises, the minimum public ownership was set at 10%.¹¹⁷ Promoters that held in excess of 75% were required to dilute their holdings. A logical follow through to this development would be that between 2011 and 2015 there is likely to be dispersion rather than concentration. I now test for any effect of this

¹¹⁰ *Ibid.*, pp. 836-8.

¹¹¹ Chandrachud, ‘The Emerging Market for Corporate Control in India’, p. 199.

¹¹² N. Balasubramanian and R.V. Anand, ‘Ownership Trends in Corporate India 2001 – 2011: Evidence and Implications’, Indian Institute of Management Bangalore Working Paper No: 419 (2013) (available at <http://ssrn.com/abstract=2303684>). This study relies on shareholding patterns of top 100 listed companies on the National Stock Exchange.

¹¹³ *Ibid.*, p. 22.

¹¹⁴ *Ibid.*

¹¹⁵ For a similar observation on Singapore, see n. 36 above.

¹¹⁶ Securities Contracts (Regulation) (Amendment) Rules, 2010.

¹¹⁷ Securities Contracts (Regulation) (Second Amendment) Rules, 2014. However, this limit has since been raised to 25% to be effective in 2017. Securities Contracts (Regulation) (Second Amendment) Rules, 2014.

regulatory development, which will also impact the possibility of hostile takeovers in India.

I gathered data on shareholding pattern of companies listed on the National Stock Exchange of India Limited (NSE), India's largest stock exchange.¹¹⁸ Under regulations prescribed by SEBI, listed companies are required to periodically file their shareholding pattern with the exchanges indicating, among other things, the percentage of promoter shareholding.¹¹⁹ I examine the shareholding data for companies within three well-known indices:¹²⁰

- (i) the CNX Nifty, a well diversified 50 stock index accounting for 23 sectors of the economy and representing about 66.17% of the free float market capitalization of stocks listed on the NSE;
- (ii) the CNX 100, a diversified 100 stock index accounting for 38 sectors of the economy and representing about 78.57% of the free float market capitalization of stocks listed on the NSE; and
- (iii) the CNX 500, a broad based benchmark of the Indian capital market and representing about 95.77% of the free float market capitalization of stocks listed on the NSE.

Table 5
Promoter Shareholding Data as of 31 March 2015

Parameters for Analysis	CNX Nifty	CNX 100	CNX 500
Average Promoter Shareholding	49.22%	52.17%	54.62%

¹¹⁸ N. Balasubramanian and R.V. Anand, 'Ownership Trends in Corporate India 2001 – 2011', p. 11; 'NSE top-ranked globally for equity trades for 2nd year in 2013', The Economic Times (19 January 2014).

¹¹⁹ Listed companies are required to make these filings within 21 days at the end of each quarter. Listing Agreement, cl. 35. The NSE maintains a database of these filings at <http://www.nseindia.com/corporates/corporateHome.html?id=spatterns>. I have sourced the data from this database.

¹²⁰ Details regarding these indices are available at http://www.nseindia.com/products/content/equities/indices/cnx_nifty.htm.

Median Promoter Shareholding	49.77%	52.36%	54.88%
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Comparing the data in Table 5 with previous studies discussed above, it is clear that the promoter holdings in 2015 are more concentrated than those in 2007, but they are less concentrated compared to 2011. This indicates that while there was a trend of further concentration during the period between 2001 and 2011, there has been some level of dispersion thereafter. This is perhaps attributable to the legal requirement of minimum public shareholding introduced by the Government, and implemented by SEBI no later than June 2013. This might indicate a trend whereby gradual loosening of concentration could open up the possibility for hostile takeover activity. In order to test this further, I examine the different levels of control exercised by promoters in these companies.

Table 6
Levels of Promoter Control as of 31 March 2015

Parameters for Analysis	CNX Nifty	CNX 100	CNX 500
Companies in which promoters hold more than 50%	25 (50%)	58 (58%)	315 (63%)
Companies in which promoters hold 25% to 50%	17 (34%)	33 (33%)	156 (31%)
Companies in which promoters hold less than 25%	4 (8%)	4 (4%)	18 (4%)
Companies which have no designated promoters	4 (8%)	5 (5%)	11 (2%)
Total	50 (100%)	100 (100%)	500 (100%)

Table 6 shows that in a majority of the listed companies in India, the promoters hold more than 50% shares in the company thereby exercising legal control. This secures their position and prevents any form of hostile takeovers. At the end of the spectrum, there are a few companies in which either the promoters hold less than 25% or they have no promoters, which are exposed to hostile takeovers. This list comprises 8 companies in the CNX Nifty (16%), 9 companies in the CNX 100 (9%) and 29 companies in the CNX 500 (6%). The exposure is higher among the larger companies in the CNX Nifty and reduces among the wider pool. While this suggests that hostile takeovers may be more likely in larger companies, it also means that the size of such takeovers and the financing required will be correspondingly high. Moreover, out of the above list, 5 companies in the CNX Nifty, 6 in the CNX 100 and 15 in the CNX 500 are in the financial services sector, which are subject to foreign investment limits and stringent approvals processes for large acquisitions. Therefore, while the possibility of hostile takeovers exists statistically in these companies, the institutional factors may pose a greater impediment.

The final group of companies is where the promoters hold between 25% and 50% shares. This consists of about a third of each of the three indices as set out in Table 6. In this group, promoters are able to exercise de facto control as they hold a significant number of shares, although less than a majority of voting rights. More significantly, they are able to exercise rights unavailable to outside acquirers. These include the creeping acquisition mechanism for shoring up their holdings and exemptions for rearranging their holding structures. At the same time, they could be vulnerable to hostile takeovers with the presence of large outside block holders who may pose a threat. In order to assess the magnitude of this threat, I examine the extent of outside blocks in companies where promoters hold between 25% and 50%. For this purpose, I consider cases where in such companies individual shareholders or group of shareholders hold at least 15% shares in the aggregate, but with each individual shareholder or group holding at least 5%.¹²¹ Based on this analysis, 2 out of 17 companies in the CNX Nifty (12%), 5 out of 33 companies in the CNX 100 (15%) and 42 out of 156 companies in the CNX 500 (27%) are exposed to outside block holders. In this group, the larger companies seem less exposed to the relatively smaller ones.

Through this study of shareholding patterns in Indian companies as of 31 March 2015, I find that companies in which promoters hold less than 25% shares or those that have no promoters would be susceptible to hostile takeovers. Similarly, companies where

¹²¹ Under the listing agreement, companies are required to separately list shareholders or groups of shareholders holding 5% or more shares in the company.

promoters hold between 25% and 50% shares, but where large block holders hold a significant stake would also be vulnerable to hostile takeovers. But, this statistical optimism for a market for corporate control must be tempered with ground realities where promoters may rely upon measures such as creeping acquisition to solidify their position in the company, and in the case of foreign acquisitions they could rely upon investment limits and also appeal to political nationalism.

VI. Policy Implications and Lessons for the Future

The evolution of the market for corporate control has been steeped in a regulatory conundrum that attempts to address somewhat conflicting objectives. On the one hand, the regulatory efforts have been to “internationalize” India’s takeover regulation by adopting best practices from other jurisdictions, primarily the UK.¹²² On the other hand, they have provided sufficient leeway to incumbents to protect their own domestic interests.¹²³

Matters such as creeping acquisition limits, partial offers and widespread exemptions from the MBR are evidence of the need to cater to the domestic incumbent groups. However, this theory fails to account for one important aspect: the board neutrality principle enshrined in the Takeover Regulations as a result of the stringent “no frustration” rule. If domestic incumbents had a role to play, why might they have accepted this outcome and not grant target boards extensive defensive measures to protect themselves against hostile takeovers? The clue to this puzzle lies in the fact that hostile takeovers have yet to capture the attention of regulators and incumbents in a significant manner due to the high concentration of shareholdings. The threat perceptions are arguably not material yet. However, given the possible dispersion of shareholding in Indian companies and the exposure of a handful of such companies to potential hostile takeovers, this issue is likely to gather steam in the future.

Interestingly, at each stage the Takeover Code has been devised through a public consultative process rather than through clandestine arrangements.¹²⁴ Such a consultative process leaves trails of influence of interest groups. In fact, the interest group dynamics may have been the unintended consequence of a consultative process that is otherwise desirable. The evolutionary process of the Takeover Code was led by

¹²² Armour, Jacobs and Milhaupt, ‘The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets’, p. 282; Banaji, ‘Thwarting the market for corporate control’, p. 8.

¹²³ *Ibid.*

¹²⁴ U. Varottil, ‘Comparative Takeover Regulation and the Concept of ‘Control’’, pp. 17-8.

committees constituted by SEBI that proposed the specifics of the reforms. The committees not only had strong representation from Indian industry, but they also comprised leading Indian corporate lawyers. The Indian industry perspective received a dominant voice in the shaping of takeover regulations. This would explain the working of the interest group theory in emboldening incumbent shareholder interests in Indian companies that militate against a meaningful market for corporate control.

From a normative perspective, and in anticipation of the growing market for corporate control in India, SEBI ought to display greater clarity in its regulatory position regarding the market for corporate control.¹²⁵ In terms of interest groups, the growing influence of institutional shareholders, particularly foreign institutional investors, in the Indian market could potentially alter the shape of the regulation, at least on an incremental basis. Institutional shareholders have become more active in recent times, and they are also guided by growing crop of proxy advisory firms. Hence, while the incumbents would continue to hold a strong sway in the regulatory process, they would have to counter the pressures from institutional shareholders that might dilute the effect of incumbents. It would be imprudent to predict radical changes on this account in the near future. Much would depend on the process SEBI follows in further developing the Takeover Code, and more importantly the composition of the committees that may design changes to the Code. While institutional investors may likely obtain some representation in the process, it would be unduly optimistic to expect them to dilute the influence of the incumbent shareholder interests. We are unlikely to witness the kind of sway that institutional shareholders have held in designing the form of takeover regulation in the UK.¹²⁶

Appellate bodies such as the SAT and the Supreme Court could continue to play a significant role in shaping the nature of takeover regulation. These bodies are unlikely to be affected by interest group dynamics as they are focused more on the resolution of disputes at hand. Nevertheless, in the Indian institutional context, it would be imprudent to rely excessively on the judicial set up for policymaking on takeovers due to the delays and costs associated with litigation process in India.¹²⁷

Given the turbulent history of takeover regulation in India within a short span of two decades, it is reasonable to expect ongoing changes in the future as well. While it would

¹²⁵ Mathew, 'Hostile Takeovers in India', pp. 841-2.

¹²⁶ Armour and Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why?', p. 1767.

¹²⁷ For a discussion of the delays before Indian courts, see J.K. Krishnan, 'Globetrotting Law Firms', *Georgetown Journal of Legal Ethics* 23 (2010), 57-102, p. 70; J. Armour and P. Lele, 'Law, Finance, and Politics: The Case of India', *Law and Society Review*, 43 (2009) 491-526, p. 496.

help for the regulatory process to take note of developments in other leading and comparable jurisdictions, necessary caution must be exercised in adopting laws and regulations from other jurisdictions without adapting them to the local structural, legal and institutional conditions.

VII. Conclusion

The market for corporate control in India operates very differently from the market in developed jurisdictions that display greater dispersion of shareholdings among listed companies. The concentration of shareholding in Indian companies coupled with the influence of domestic incumbent business groups has led to significant limitations for a market for corporate control. A stringent MBR, together with additional features such as creeping acquisition and exemption mechanisms, strengthen the position of incumbents against outside acquirers. Empirical analysis of the operation of India's Takeover Code confirms this result. This is consistent with the operation of the interest group analysis of takeovers that is becoming prominent in the literature.

As for the future, the market is likely to change due to some level of dilution on shareholding concentration of Indian companies and greater participation by outside block holders in decision-making. Hence, the regulatory establishment must be in a greater state of preparedness to deal with contests for control as they arise. My effort in this paper has been to provide a macro-level analysis both conceptually and empirically in the design and functioning of takeover regulations. This will benefit further from future research on several individual aspects of takeover regulation such as the MBR, the concept of 'control', creeping acquisition, exemption mechanism and the possibility of hostile takeovers, which will have to await another day.
