Anti-Takeover Missiles

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In what is touted as the first hostile takeover of a company in the country, Indian conglomerate Larson & Toubro has successfully completed its takeover of IT company Mindtree. As per L&T, initially, Cafe Coffee Day founder VG Siddhartha who was facing pressures of liquidity approached them offering to sell his stake in the company in March 2019. Interestingly, Siddhartha was the single-largest non-promotor shareholder having 20.32 per cent stake in Mindtree. L&T offered him Rs 980 per share, which approximately amounted to Rs 3,269 crores. This offer was vehemently opposed by the management of Mindtree which set stage for a hostile acquisition.

In March 2019, Chairman of L&T AM Naik in his address to the media had explained how the acquisition of Mindtree a value addition was. The Indian conglomerate already has a listed IT company - L&T Infotech which focuses on BFSI vertical whereas, Mindtree largely focuses on clients from hospitality and retail sector. So, a takeover would mean an expansion of L&T's information technology business.

Many of the Corporate Lawyers say that transfer of shares in a company can be restricted by way of adding necessary covenants in the Articles of the company which are in essence the company's charter documents. "In the ordinary course, this restriction is exercised by the board to ensure the best interest of the company. In the case of public companies, however, this is a tenuous issue and several noted judgments have opined that any restriction on the free transferability of shares in a public company is not maintainable.

Definition of Takeover

Broadly speaking, takeover refers to acquisition of company by another company. Takeover is an acquisition of shares carrying voting- rights in a company with a view to gain control over the management of the company. It takes place when an individual or a group of individuals or a company acquires control over the assets of a company either by acquiring majority of its shares or by obtaining control of the management of the business and affairs of the company. When an acquirer makes a bid for a target company, if the takeover goes through, the acquirer becomes responsible for all of the target company's operations, holdings, and debt. When the target is a publicly traded company, the acquiring company will make an offer for all of the target's outstanding shares.

Advantages of Takeover

International Growth & Restructuring

Businesses can make their services or products available globally by acquiring businesses in various locations internationally. For instance, Belgium brewing company, InBev took over Budweiser for $52 billion in 2008 in order to expand its presence in the U.S. market and create one of the largest consumer beverage companies in the world.

Expansion

Sometimes companies will take over other companies that are in trouble, for example, Reliance Industries-Future Group deal has saved lenders from a $2.2 billion debt. Future Group lenders have been saved from a $2.2 billion hit on their exposure to the conglomerate after the company announced its sale of all its businesses to Reliance Industries (RIL) for ₹24,713 crore. Lenders led by Axis Bank have a total exposure of ₹16,000 crore to the conglomerate. Analysts believe that there is most likely no haircut to lenders who have lent for business operations.

Types of Takeover

Legal Context

Friendly or Negotiated Takeover

Friendly takeover means takeover of one company by change in its management & control through negotiations between the existing promoters and prospective investor in a friendly manner. Thus it is also called Negotiated Takeover. This kind of takeover is resorted to further some common objectives of both the parties. Generally, friendly takeover takes place as per the provisions of the Companies Act & SEBI guidelines.

Hostile Takeover

Hostile takeover is a takeover where one company unilaterally pursues the acquisition of shares of another company without the knowledge of that other company. The most dominant purpose which has forced most of the companies to resort to this kind of takeover is increase in market share. The hostile takeover takes place as per the provisions of SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011.

Bail Out Takeover

Takeover of a financially sick company by a profit earning company to bail out the former is known as bail out takeover. There are several advantages for a profit-making company to takeover a sick company. The price would be very attractive as creditors, mostly banks and financial institutions having a charge on the industrial assets, would like to recover to the extent possible.

Business Context

In the context of business, takeover is of three types:

Horizontal Takeover

A horizontal Takeover involves two companies, operating and competing in the same industry. The motives are as usual several, but the most general goal is to seek advantages in economics of scale by improving the management and administration of the company as well as better take advantage of the unused and available capacity in production. Furthermore, horizontal acquisitions have a negative impact on competition, in the sense of increased potential monopoly revenues for companies, while firms gradually decrease from the market or being bought up. These types of acquisition are relatively common, since a company's growth strategy often include acquiring other companies, operating in the same industry. When a company wants to go abroad and establish its presence in a foreign country which it has never operated in before, it is generally known that acquiring an already established firm with a brand which is already known in the region with existing product and supply chains is many times a lot easier and more cost efficient than trying to establish one's unknown brand in that region from scratch. After an acquisition, the companies merged together, often adopts a brand name in the beginning, including both the previous companies' names, illustrating that an acquisition has been made but also to ensure a feeling of comfort for the acquired company's already existing customers.

Vertical takeover

A vertical Takeover takes place when a company gains ownership over a company, operating in the same industry as the acquiring company. As we have mentioned before, the reasons and motives for the acquiring company could be several, but usually the acquiring company chooses to implement a vertical acquisition in order to establish control of the whole production chain, thus potentially securing and strengthening its market position. One example of vertical acquisition could be when an airline company gains ownership over a travel agency. By doing so, the airline company prevents the possibility for the travel agency to change airline in the future, as well as improving and developing its marketing strategy, which could be for instance marketing of travel and flights to destinations where the airline has the most available flights

Conglomerate takeover

A conglomerated takeover occurs when a company gains ownership over another company, operating and existing in an entirely different kind of industry. These types of acquisitions are often made in the purpose of diversifying one's risks and are often performed by companies which have their core businesses in a relatively high-risk type on industry. The main goal is to seek a sustainable platform with interests and operations in different types of industries entirely independent of each other, risk diversifying and enabling the possibility of one industry which it has interests in to be profitable, while other industries might have a downturn, since it is normal for some industries to do better when others are doing worse

Defence Strategies to Takeover Bids

All bids that are made between companies are not always welcomed with open arms from the target company's board of directors. In that case the bid is recognized as hostile, also called unconsolidated bid.

This occurs when the acquiring company is trying to acquire the target company directly through its share holders rather than through a mutual agreement with the target company's board of directors Defenses can take the form of fortifying one self, i.e., to make the company less attractive to takeover bids or more difficult to take over and thus discourage any offers being made.

Types of Defence

The "Crown Jewel" Strategy

Under this strategy the hostile bidder is deprived of the primary intention behind the takeover bid. Vide this novel strategy, the target sells off not only the crown jewel in its possession (assets) but also properties to diminish its worth. Such a radical step may however be, self-destructive and unwise in the company's interest.

The “Packman” Defence

This strategy, although unusual, is called the packman strategy. Under this strategy, the target company attempts to purchase the shares of the raider company. This is usually the scenario if the raider company is smaller than the target company and the target company has a substantial cash flow or liquid asset

Targeted Share Repurchase or “Buyback”

This strategy is really one in which the target management uses up a part of the assets of the company on the one hand to increase its holding and on the other it disposes of some of the assets that make the target company unattractive to the raider. The strategy therefore involves a creative use of buyback of shares to reinforce its control and detract a prospective raider An example that demonstrates this contention is the distribution of high dividends in a particular year if not followed in the next sends the share prices spiralling down.

“Golden Parachutes”

Golden parachutes refer to the “separation” clauses of an employment contract that compensate managers who lose their jobs under a change-of-management scenario. The provision usually calls for a lump-sum payment or payment over a specified period at full and partial rates of normal compensation. The provisions which would govern a “golden parachute” employment contract in India would be under Section 202 of the Companies Act, 2013 which govern the provisions compensation for loss of office. Thus, a perusal of the said provisions would show that payments as compensation for the loss of office is allowed to be made only to the managing director, a director holding an office of manager or a whole time director. Therefore, “golden parachute” contracts with the entire senior management, as is the practice in the U.S., is of no consequence in India.

Anti-takeover amendments or “shark repellents”

An increasingly used defence mechanism is anti-takeover amendments to the company’s constitution or articles of association, popularly called “shark repellents”. Thus, as with all amendments of the charter/articles of association of a company, the anti-takeover amendments have to be voted on and approved by the shareholders. The practice consists of the companies changing the articles, regulations, bylaws etc. to be less attractive to the corporate bidder.

Anti-takeover amendments generally impose new conditions on the transfer of managerial control of the firm through a merger, tender offer, or by replacement of the Board of Directors. In India every company has the clear power to alter its articles of association by a special resolution as provided under Section 31 of the Companies Act.

Refusal to Register Transfer of Shares

Refusal by the Board of Directors to register a transfer is an important strategy to avert a takeover.

Poison Pill Defences

A controversial but popular defence mechanism against hostile takeover bids is the creation of securities called “poison pills” (DVR Shares). These pills provide their holders with special rights exercisable only after a period of time following the occurrence of a triggering event such as a tender offer for the control or the accumulation of a specified percentage of target shares. These rights take several forms, but all are difficult and costly to acquire control of the issuer, or the target firm.

Legal Issues Concerning Poison Pill Devices

The legality of poison pills has been questioned in court of law because they alter the relationships among the principals (shareholders) without their approval by vote. In most poison pills, the agents (Board of Directors) adopt rights plans which treat shareholders of the same class unequally in situation involving corporate control.

Takeover of companies whose securities are listed on one or more recognized stock exchanges in India is regulated by the provisions of the Listing Agreements with various stock exchanges and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the Regulations)

The aforesaid transactions are regulated in the following manner:

1. Acquirer is required to make mandatory public offer (Open Offer Obligations); and
2. Acquirer is required to make certain disclosures (Disclosure Obligations).

The advantages of taking over companies through a takeover or mergers are numerous. Companies can boost revenue streams and market share, broaden their product base or increase their international presence through taking over companies. The companies in the best position to buy out another company are those with extra cash and balance sheets that have reached maximum revenue potential and need to make a strategic change in order to grow.

Takeover or merger is a detailed and complex procedure requiring the analytical skills and accounting knowledge of a Chartered Accountant, the legal knowledge and the secretarial expertise of a Company Secretary.

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