

## CHAPTER SEVEN

## **C H A P T E R   S E V E N**

### **S U M M A R Y   A N D   R E C O M M E N D A T I O N S**

The study was made to inquire into the wealth maximisation effects and to discern the strategic moves underlying a takeover process, be it successful or otherwise. The broad inferences of investigation and findings are given in detail in the previous chapters. This chapter presents the summary of the findings and offers policy recommendations with a view to imparting efficiency in the market for corporate control. Accordingly, this chapter is divided in three parts. Part one presents a summary of the main findings of the study. Part two offers policy recommendations for making market for corporate control more efficient. Part three concludes the study by suggesting the areas for further research.

#### **7.1.   S U M M A R Y     O F   F I N D I N G S**

The present study has (i) analysed the returns to shareholders of the target and the bidder companies involved in takeovers; (ii) assessed the efficiency of the stock market; (iii) made a case study of L&T Ltd. takeover by Ambanis; and (iv) explored the motivations of the managers and the strategies and tactics adopted in the takeovers. This section presents the summary of the findings relating to these aspects.

#### **7.1.1. Theory of Takeover**

Classical theory holds that the management will maximise the shareholders' wealth. If it does otherwise, the market will swiftly replace it through takeover mechanism. But the separation of ownership from control in the corporate form of organisation has reduced the efficacy of the market forces to replace it as assumed by the classical theory of firm. Therefore, recognising the imperfections due to the dispersed ownership of the firm in the market, the managerial theory holds that after attaining satisfied level of performance, the management may afford to indulge in maximising their utility.

Agency theory holds that the firm is a nexus of contract between the shareholders (principals) and the management (agent). The shareholders entrust their resources to the management to utilise them in formers' interest for the agency cost. It holds that the competition among the managements for acquiring control over corporate resources from the shareholders in the market for corporate control will lead to maximisation of the shareholders' wealth subject to agency cost. The value of agency cost depends on the degree of competition in and efficiency of market for corporate control. Thus, in a perfectly competitive and efficient market, the agency theory converges to the classical theory of firm. If market is imperfect, it may give rise to managerial capitalism.

Managerial capitalism which, exploded in late nineteenth century due to corporate form of organisation is observed to have taken the reverse turn in late twentieth century. This might be due to the excessive indulgence of the management in the hubris. The corporate governance has been observed to have forced the management to buyout the firms to retain their control. This is observed to have led to realignment of the ownership with control, which in turn, have led to maximisation of the shareholders' wealth and efficient utilisation of the resources.

Takeovers are observed to have been studied from varied dimensions. These dimensions are: (i) profitability of the target before and after the takeover; (ii) returns to shareholders and market efficiency around the takeover event; (iii) motivations for takeover for the bidder and the target; and finally (iv) the style and the strategies adopted by the raiders.

#### **7.1.2. Wealth Maximisation Hypothesis**

The behaviour pattern of CARs was used to measure the wealth impact on the shareholders of the participating companies in case of takeovers. Following are the inferences with regard to the wealth maximisation hypothesis of shareholders of the target and the bidder during the takeover process.

##### **Target: Aggregate Analysis**

- (i) In the pre-event period, on an average the target experienced 2.4 per cent CARs which were found to be

statistically insignificant.

- (ii) In the event period, target gained 49.5 per cent CARs which were found to be statistically significant.
- (iii) In the interim period, it experienced 14.5 per cent CARs which were found to be statistically significant. This period marked adjustment process in share prices depicting consistently positive CARs.
- (iv) In the post-event period, it suffered -25.7 per cent statistically significant CARs wiping out more than one third of what it had gained during the event and the interim period.
- (v) During the overall takeover process, on an average, the target realised net 40.8 per cent CARs which were found to be statistically significant.

#### **Hostile vs Friendly Takeovers**

- (i) In the pre-event period, the hostile targets experienced consistently positive (6.2 per cent) but statistically insignificant CARs, while, the friendly targets depicted mixed (positive as well as negative) behaviour of statistically insignificant CARs. In all, they were found to be -0.5 per cent.
- (ii) In the event period, both the hostile and the friendly targets gained substantial and statistically significant CARs. They were found to be 59.5 per cent and 49.5 per cent for the hostile and the friendly targets respectively.
- (iii) In the interim period, the hostile targets earned 35.3 per cent statistically significant CARs; while the

friendly targets suffered -1.5 per cent CARs which were found to be statistically insignificant.

- (iv) The post-event period revealed substantially negative CARs which were found to be statistically insignificant for the hostile targets (-31.9 per cent) and significant for the friendly targets (-19.6 per cent).
- (v) During the overall takeover process, the hostile targets realised net 68.8 per cent statistically significant CARs. While the friendly targets managed to register net 20.7 per cent CARs which were found to be statistically insignificant.

#### **Successful vs Unsuccessful Takeovers**

- (i) In the pre-event period, the successful and the unsuccessful targets were observed to have experienced mixed behaviour (positive as well as negative) of statistically insignificant CARs. They were 3.5 per cent and 0.9 percent for the successful and unsuccessful targets respectively.
- (ii) In the event period, the successful and the unsuccessful targets gained 50.3 per cent and 48.8 per cent CARs respectively. They were found to be statistically significant in both the cases.
- (iii) In the interim period, the successful targets gained 0.6 per cent statistically insignificant CARs; while the unsuccessful targets gained 28.7 per cent statistically significant CARs.
- (iv) In the post-event period, the successful targets suffered -38.6 per cent statistically significant CARs, while the

unsuccessful targets suffered -16.9 per cent statistically insignificant CARs.

- (v) During the overall takeover process, the successful targets realised net 14.2 per cent statistically insignificant CARs. While the unsuccessful targets earned net 63 per cent statistically significant CARs.

#### **Effect of Attitude of the Target and Outcome of Deal on Takeover Process**

The analysis of the effect of hostility, assistance, failure and success of takeover during its varied phases, permits to infer that

- (i) In pre-takeover period, the resistance by the target was observed to have generated positive CARs, in contrasts with the assistance by the target which generated negative CARs. The CARs in both the cases were found to be statistically insignificant.
- (ii) In the event period, not the hostility, but the probability of success of the deal was observed to have generated higher positive CARs.
- (iii) In the interim period, not the failure, but the resistance by the target was observed to have generated higher positive CARs.
- (iv) In the post-event period, it is the success of the deal that pull down the CARs substantially. The attitude of the target was observed to have no influence on the behaviour of CARs in this period.

To sum up, an average target firm was observed to have gained by the takeover process leading to the maximisation of its shareholders' wealth.

### **7.1.3. Hubris Hypothesis : Target vs Bidder**

The analysis of CARs of successful and unsuccessful takeover attempts of L&T by the Ambanis led to following inferences:

- (i) The target is more sensitive than the bidder to news releases related to takeover attempt. In anticipation of takeover attempts (successful as well as unsuccessful), the target was observed to have earned higher than the bidder. The target earned 29.2 per cent CARs over twenty four days and 22.3 per cent CARs over seven days before the respective event dates; while the bidder earned 1.7 per cent CARs over fifteen days and 22.4 per cent CARs over fifteen days before the respective event dates.
- (ii) The confirmation of identity of the bidder is normally followed by the negative CARs for both the target and the bidder as well. The target suffered -9.3 per cent CARs while the bidder suffered -3.4 per cent CARs nine days after the event day.
- (iii) During the bidders' regime over the target, the latter suffered negative CARs (5.7 per cent), while the former earned positive CARs (20 per cent).
- (iv) The target lost while the bidder gained on unsuccessful takeover attempt. The target suffered -9.9 per cent CARs, as compared with the bidder who gained 10.9 per cent CARs.



This drives us to the conclusion that bidder and target both have gained. This refutes the hubris hypothesis proposed by Roll (1986) based on the studies conducted in the U.S.A. However, this conclusion is the result of a single case study.

#### **7.1.4. Market Efficiency**

The examination of behaviour of CARs during the takeover process suggests that market behaviour seems to be consistent with semi-strong form of efficiency. This is supported by the results of the case study as well. However, the evidence lacks conclusion. The behaviour of the market during the pre-takeover and event period reasonably evidences its consistency with semi-strong form of efficiency. But its behaviour in the interim period and the post-takeover period, especially in case of, the successful and friendly takeovers, does not confirm its consistency with semi-strong form of efficiency.

The overall results suggest that takeover attempts generate gains for the shareholders of the target. They are consistent with the hypothesis that managers' involvement in takeovers maximises shareholders' wealth. The evidences for the targets' shareholders are found consistent with the empirical evidences reported in the U.S.A. (Jensen and Ruback, 1983) and the U.K. (Franks and Haris, 1989). The evidences reporting significant gains to the bidders' shareholders are unique. However, this is the result of a single case study. The examination of the behaviour of CARs during the takeover process (from the pre-event to the post-event period) suggests that market behaviour seems to be consistent with semi-strong form of efficiency with

weak evidences.

The analysis of the hostile and the friendly takeovers suggests that the resistance of the target management to the takeover attempt increases the gains to target's shareholders. It is consistent with the findings of Franks and Harris (1989) that contested bids lead to higher target wealth effects in both the countries, namely, the U.S. and the U.K. The analysis of successful takeovers suggests that takeovers are not initiated for reallocation of target resources more efficiently exposing an element of *corporate raiding*. The reported gains to the bidder, in this case, are inconsistent with hubris hypothesis (Roll, 1986). The analysis of the unsuccessful takeovers suggests that the takeover attempts either initiate reassessment of the value of the target or discipline the target management to improve its performance in future. This supports improved management hypothesis (Bradley, Desai and Kim, 1983) or internal efficiency hypothesis (Dodd and Ruback, 1977). Positive abnormal returns to the bidder, in this case, exposes an existence of hubris on part of the bidder.

#### **7.1.5. L & T Case Study**

The implications that flow from the critical evaluation of the subtleties of the successful and the unsuccessful takeover attempts on L&T by the Ambanis, are as under:

- (i) Legal provisions are neither sufficient nor adequate and ambiguous too, to enforce corporate democracy and transparency in corporate takeover transactions. The penal provisions are not deterrent enough to warrant

their observance in letter and spirit.

(ii) The decisions of the public financial institutions as a major shareholder related to transfer of corporate control were found to be inconsistent and erratic. But subtly, they were perfectly coincided with change of the Government at the center.

(iii) The belief that high profitability, growth potential or even professionalism may immune the company from the takeover was belied. Precisely, these were the factors that tempted the bidder to raid L & T. The shareholding pattern and the succession problem made L&T a suitable prey.

#### **7.1.6. Corporate Takeovers in Indian Corporate Scene**

Analysis of motivations for and strategies and tactics adopted by the market participants in market for corporate control revealed the following pattern:

**Type of the Target :** The bidders preferred non-sick companies (80 per cent) for takeovers. Of these few (40 per cent) were reported to have unutilised potential resources. Remaining (20 per cent) of the targets were either sick or BIFR referred companies.

**Mode of Acquiring Controlling Interest in the Target :** In 70 per cent of the cases negotiated deals were resorted to for acquiring the controlling stake. It is followed by open market purchases, public tender offers and rights issue which were reported in 39 per cent, 13 per cent and 12 per cent respectively. More than one routes were preferred for the

purchase of the controlling stake. It was observed that the negotiated deals were preferred in assisted takeovers; open market purchases were resorted to in resisted takeovers; and public tender offers were found to be in vogue in competitive bids.

**Response of the Target :** 52 per cent of the studied cases were found to be assisted takeovers. They were followed by resisted (45 per cent) and competitive (20 per cent) takeovers. 72 per cent of assisted takeovers were found to be successful, 55 per cent of resisted takeovers were found to be unsuccessful, and 80 per cent of the competitive takeovers were found to be successful takeovers.

**Result of Takeover Attempt :** The Indian corporate scene is dominated by successful takeovers as more than 70 per cent of the cases were found to be successful, while unsuccessful accounted for 30 per cent.

**Role of the Financial Institutions :** The role of FIs was observed to be less than unambiguous. The FIs were observed to have (a) remained neutral in takeover attempts (44 per cent cases); (b) supported the bidder (14 per cent cases); (c) supported the target (12 per cent cases); and (d) taken over the control in the selected cases (7 per cent). In 23 per cent of cases their role was not known publicly. The attitude of FIs was not observed to have any distinct pattern for supporting the bidder or the target or remaining neutral on strategies and tactics adopted in the takeover, vis-a-vis the attitude of the

target to the attempted takeover.

**Objectives for the Bidder :** In 40 per cent of the cases the underlying objective of takeover was conglomerate diversification, while in other cases it was horizontal expansion (29 per cent) and vertical integration (13 per cent). Functionally, the takeovers were also resorted to combine the manufacturing capabilities (53 per cent), exploit the financial potentialities (52 per cent) and expand the marketing territories (44 per cent). The major reasons reported by the bidder for undervaluation of the target were unexploited potential of the target (40 per cent cases), inefficiency (38 per cent cases) and dormancy of management (20 per cent cases). Motivations for takeovers stemmed from the bidders' corporate philosophy, followed by conflicts among the existing controllers.

**Objectives of the Target :** It was observed that in certain circumstances the target firm preferred to be taken over by the bidder. Family feuds (21 per cent cases) and the decision to dilute control (14 per cent cases) were few of such circumstances which led the firm to market for corporate control.

**Strategies and Tactics :** Wide range of strategies and tactics adopted by Indian managers to attack and defend the target. Off-shore deals marked as the most preferred route to takeover (21 per cent). It is followed by rights issues (18 per cent) which were observed to have been adopted in both the assisted

and resisted takeovers. Defensive tactics like proxy contests (15 per cent cases), initiating legal suits (15 per cent), share transfer refusal (14 per cent cases), and cornering of shares (14 per cent shares) were also found to have been widely used. Other special techniques like greenmail attempts (5 per cent cases), White Knight takeovers (4 per cent), and workers' buyouts (4 per cent) were also resorted to by Indian managers.

## **7.2. POLICY RECOMMENDATIONS**

The inevitable by-product of the recent reforms (towards liberalization, privatisation and globalisation of Indian economy) would witness the unabated spate of takeovers and merger transactions heralding an *exit policy* for inefficient corporate leaders. To ensure efficient and transparent working of the market for corporate control the following section offers the policy recommendations.

### **7.2.1. Takeover Code**

To ensure transparent dealings in market for corporate control and to protect the interests of shareholders, the SEBI has already circulated the "The Draft Regulation of Acquisition of Substantial Shares in Listed Companies" or Takeover Code (See Appendix 7.1). The following amendments to the proposed draft regulations are suggested to ensure efficiency in the market for corporate control.

- (i) The phrase "acting in concert" needs clarification in explicit terms to make it robust against subjective and ambiguous interpretation.
- (ii) The responsibility on the target to inquire about the "person acting in concert" and reporting to SEBI be withdrawn.
- (iii) There should be highly deterrent penal provisions if the bidder backs out of the tender offer.
- (iv) The provision of six weeks to call an extra ordinary general meeting (EGM) to confirm the refusal of transfer of shares is too short, and therefore, it is recommended to be extended to eight weeks.

#### **7.2.2. Separate Regulating Body**

To avoid multiplicity of regulations and complicated network of agencies to enforce them, it is recommended that all these regulations relating to takeovers be combined and vested in one autonomous body similar to that of SEBI to make the monitoring and transfer of corporate control more effective and speedy. This body would be expected to discharge the following functions:

- (i) frame and implement the rules and guidelines relating to disclosures, public offers, proxy contests, and refusal to transfer the shares;
- (ii) advise in designing the takeover transactions in the interests of shareholders and the public; and finally,
- (iii) comment on and approve the strategies and tactics adopted in the takeover.

### **7.2.3. Legal Provisions**

To make the existing legal provisions more effective and deterrent enough to prevent their blatant violation, the criminal liability leading to imprisonment be incorporated in Sections 163(5), 111(2) and 111(9) of the Companies Act, 1956. The provision of Section 176 (7) of the Companies Act, 1956, be modified to extend the period of inspection of the proxies up to seven days before the date of the meeting. This would also require the modification in the last date of submission of the proxies to eight days before the date of the meeting.

### **7.2.4. Tax Provisions**

In order to remove confusion in tax provisions related to capital gains section 2(7) of The Income Tax Act, 1961, is required to be modified to incorporate exemption to takeover transaction under share-to-share exchange arrangement. The sale consideration to the shareholders of the target and cost of target shares to the bidder require clarification under such arrangement

### **7.2.5. Turnaround the Sick Companies through Takeovers**

To encourage the takeover of the sick targets, the study recommends that:

- (i) Restrictions on managerial remuneration under Section 198 to 201 and Schedule XIII of the Companies Act, 1956, should be relaxed for the period of five years from the year the company gets turned around. Similarly, restrictive provisions under Section 370 and 372 of the



Companies Act, 1956, should also be relaxed.

- (ii) Section 79 of the Income Tax Act, 1961 should be scrapped to allow benefit of carry forward and set off of unabsorbed losses, allowances or depreciation on change of ownership of the company, even when the transaction is not covered under Section 2 (1B) and 72 A of the Income Tax Act, 1961.
- (iii) To ensure speedy approval from the Appropriate Authorities under Section 72 A of the Income Tax Act, 1961, the powers under this section are suggested to be vested in a separate autonomous body as proposed in para 7.2.2.

#### **7.2.6. Code of Conduct for Institutional Investor**

In order to protect the target managements from collusive voting by the institutional investors, it is recommended that a self-regulatory association for different kinds of institutional investors be constituted on the basis of the U.K. model where all different types of institutional investors are required to form their individual association and each such association with their respective representatives forms a City Association which would be responsible for preserving the efficiency and the integrity of the market in the interest of its own members and the public at large. Any digression from expected behaviour by member would be monitored by the Panel elected by representatives of City Association, and would be reported to respective Association which in turn would take action against the defaulting member.

#### **7.2.7. Off-Shore Deals**

In order to offer the level playing field, Reserve Bank of India should be vested with the authority to inquire into the source of the consideration when the NRI pays for acquiring controlling stake in the target (Indian) from another NRI.

#### **7.2.8 Family Feuds and Protection to Non-controlling Shareholders**

In order to avoid frustration to non-controlling shareholders on account of partition of a family, controlling more than one companies through cross-holdings, the study recommends that in the event of partition of the family and distribution of equity stakes among family factions, the non-controlling shareholders should be given an option to retain their stake in the company or to sell off to a faction of family acquiring the control of the company. The price offered to the shareholders under such offer should not be less than the negotiated price fixed for the partition or the market price whichever is higher.

#### **7.2.9. Employees and Contest for Corporate Control**

To encourage the participation of employees in the contest for corporate control it is suggested that Employee Stock Option Plan (ESOP) be enforced (Refer, Appendix 7.2).

### **7.3 AREAS FOR FURTHER RESEARCH**

This study is a modest attempt in examining shareholders' wealth maximisation hypothesis, assessing the efficiency of the stock market and exploring the motivations underlying various

strategies of managers in the corporate takeover game in India. Owing to the limited research effort in Indian conditions, the area of corporate takeovers offers a vast scope of further research. Following are some of the areas which needs to be explored further in Indian corporate settings.

- (i) Takeovers and Corporate Governance.
- (ii) Managerial Styles of the Corporate Raiders.
- (iii) Takeovers and Market Efficiency.
- (iv) Takeovers and Corporate Disclosures.
- (v) Corporate Restructuring and Takeovers.
- (vi) Corporate Mergers and Behaviour of Share Prices.
- (vii) Redistribution Effects of Corporate Takeovers and Mergers.
- (viii) Managerial Buyouts and Shareholders' Wealth Maximisation.
- (ix) Corporate Takeovers and Role of Financial Institutions.