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FAIRNESS THROUGH EFFICIENCY: THE CASE FOR A NON-MANDATORY MANDATORY BID RULE

—Karan Singh*, Kaustubh Chaturvedi** & Pallavi Khatri***

Abstract — It is commonly believed that the Mandatory Bid Rule is necessary to ensure the protection of minority shareholders, and that the inefficiency it causes is the price we must pay for fairness. In this paper, we challenge that belief. We suggest that efficiency and fairness are not competing notions – instead, in the Indian market for corporate control, an efficient regulatory regime is most likely to lead to fair outcomes. To make this point, we demonstrate that the protection the MBR grants is inherently less valuable in India than in the UK, where it originates, since takeovers in India are seller-driven and are therefore, prima facie likely to be good for the company. In this background, we empirically evaluate the takeovers that occurred between October 2015 and February 2022 to demonstrate that minority shareholders neither really need, nor particularly want the protection of the MBR. In fact, both they and every other stakeholder would likely be better off without it. However, recognising the inertia built into the regulatory framework, and the players it governs, we propose a temporary system where the MBR would not apply by default, but companies can nonetheless choose to have it be applicable to them. It is our hope that such a transitory regime will generate further evidence on the comparative

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fairness and efficiency outcomes of each system, allowing both companies and policymakers to make better decisions thereafter.

I. INTRODUCTION

Almost everything about takeover regulation is complex. This is only natural – it attempts to manage many disparate, competing and dynamic interests all at once; and it strives to do so for markets where cause and effect is difficult to assess. Consequently, for much of what has been said about the role and impact of takeover regulation on the market for corporate control, the opposite has also been said, and with good reason.

This divergence is also reflected in the regimes opted for by two dominant legal jurisdictions – the United States of America ('USA') and the United Kingdom ('UK'). Despite having market economies and otherwise similar legal systems, they have adopted diametrically opposite approaches towards regulating control transactions, with the USA opting for the Market Rule (with the accompanying Business Judgment Rule) and the UK opting for the Mandatory Bid Rule (with the accompanying principle of Board neutrality). This unusual occurrence clearly demonstrates the complexity surrounding regulatory choice on an important area of commercial activity.

In India, at least, there is little value in evaluating the suitability of the Market Rule with the accompanying Business Judgement Rule. After all, the wide powers given to the Board of a company in that paradigm to deal with hostile takeovers are of limited relevance in a concentrated market like India where control transactions are mostly friendly and therefore take place between willing buyers and sellers. Nonetheless, there remains a vast regulatory terrain to navigate, not just between these two systems, but also within the system itself, as it was when it was adopted in the UK and what it became after being transplanted in India.

While recognizing that regulations in different jurisdictions have divergent approaches, they all have or should in theory have an overarching common objective – to promote an efficient market for corporate control. Ideally, regulation should be framed in a manner that enables "good" transactions and prevents "bad" ones. It must also be recognised that regulation itself can only be so impactful in a market like India which has many natural and embedded checks on takeover activity, on account of the concentrated nature of corporate shareholding.

This requires us to be able to distinguish between "good" and "bad" transactions, an exercise most easily and perhaps best done through the lens of target performance (particularly financial performance) subsequent to a takeover. Although a takeover affects multiple stakeholders (shareholders, employees, consumers, suppliers, etc.), we believe that the analysis of "good" and "bad" transactions ought to be viewed, in spite of its limitations, from the lens of target performance only. There are a few reasons for this – target performance is objectively measurable; the impact of a takeover is more directly felt on the target than on other stakeholders, and other stakeholders might have conflicting interests with regard to a takeover.

Of course, the obvious limitation with viewing the benefits or drawbacks of a takeover from the lens of target performance is that the performance of a company is affected by several significant factors other than its takeover– changing local and global macro-economic conditions, tax and regulatory factors, and rapid changes in technology, to name a few. It is then hard to analyse in hindsight with any degree of certainty which of these factors played a role (and how much of a role) in the performance of the target post its takeover. Consequently, if the analysis of what is "good" or "bad" is based purely on target performance, it might very well be the case that what was considered with foresight to be a "good" transaction, might in fact in hindsight turn out to be a "bad" one on account of externalities that would have impacted performance regardless of the takeover. This, however, should not be the basis of eliminating the use of target performance as a point of review and analysis. Useful points of correlation can still be drawn through data on target performance around takeovers. Rather, it should serve to remind us that data must not stand alone, and that it must be supported by thoughtful analysis.

However, even if we were able to definitively identify how much of a target's financial performance is attributable to a takeover, takeover regulation's only objective cannot be to simply enable takeovers that will cause positive target performance – other factors like the fair treatment of minority shareholders also need to *prima facie* be considered.

The goal of this paper is to evaluate, through theoretical and empirical analysis, whether the Mandatory Bid Rule ('MBR'), in its present form, serves a useful purpose in India. To this end, we will first explain the original conceptualization of the Mandatory Bid Rule and then examine how the rule was transplanted in India, in Section 1. Having thus gained an understanding of the approach of past regulators and evaluated how this shaped the market for corporate control, in Section 2 we will question the assumptions which led to the adoption of the Mandatory Bid Rule, particularly its role and usefulness in the protection of minority shareholders. Building upon this, we will argue that the MBR, with its focus on ensuring fairness through the specific mechanism of an exit opportunity for minority shareholders, is inefficient and should not be

the default form of regulation in India. Fairness can instead be ensured more efficiently by reducing regulatory friction and transaction costs. We will build on this objective and make some concrete proposals for change in Section 3.

II. GENESIS OF THE MANDATORY BID RULE IN INDIA

This section deals first with the origin of the rule, and with how it was transplanted in India.

A. Origin of the Rule

The Mandatory Bid Rule ('MBR') came to be seen as necessary for ensuring the fair treatment of minority shareholders. To understand this further, a study of the evolution of the market for corporate control is warranted. This study must begin with examining the relationship between managers and shareholders.

Where managers of a company are not themselves majority shareholders, there transpires an agency problem between the managers and shareholders. A variety of measures have been taken to alleviate this agency problem, such as the creation of fiduciary duties for the board and the increasing likelihood of compensation for directors being linked to company performance. Every measure devised has helped, yet none has been able to resolve fully the inherent tension that arises out of the creation of the corporation as a separate legal entity – people watch over the wealth of others less anxiously than they would their own.[1] No single manager receives the full benefit of his work and is therefore prone to putting his own interests before those of the shareholder.[2]

When these agency costs spiral out of control and the management of a company pursues goals that deviate from shareholders' interests, then "the external takeover market serves as a court of last resort that plays an important role in protecting shareholders."[3] The worse a company is managed, the lower its share price should be relative to its possible share price, had it been managed well. The lower its share price gets, the more likely it becomes that the company will be acquired, leading to a change in management.[4] Therefore, the

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[1] Adam Smith, *The Wealth of Nations*, vol 2 (first published 1776, Random House 2000) 12.

[2] Lucian A Bebchuk, 'The Case for Facilitating Competing Tender Offers' (1982) 95 Harvard Law Review 1028, 1030.

[3] Michael Jensen, 'The Takeover Controversy: Analysis and Evidence' in John Coffee and Susan Rose-Ackerman (eds), *Knights, Raiders, and Targets: The Impact of the Hostile Takeover* (OUP 1988) 10.

[4] Henry G Manne, 'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political Economy 110, 113.

market for corporate control, is meant to function at least in theory, as a highly effective check on management autonomy.[5]

The approach that the United States takes to regulate this market[6] is very different from that of the United Kingdom (and for that matter, most of Europe or Asia). USA follows the business judgement rule,[7] which empowers the board to decide whether or not to accept a takeover bid.[8] The board can resist a takeover, provided they are acting in good faith and any defensive measures they take are reasonable in relation to the threat.[9] The theory is that managerial resistance to takeovers is the best possible way of securing the best possible terms for shareholders, who may not have the ability to effectively deal with the bidder.[10] When a bid is inevitable, offeree directors are prohibited from resisting, and are required to obtain the best price available. The business judgement rule prevents courts from second-guessing such decisions of disinterested and independent directors, acting with due care and reasonableness.[11]

The United Kingdom, continental Europe, and most of Asia don't give the board any such powers, for the reason that there exists enough of a conflict of interest between managers and shareholders in the case of takeovers that it is impossible to assume managers will act in the shareholders' best interests.[12] A value-maximizing bid for the shareholders might lead to individual directors losing their influence, or perhaps even their employment. With such perverse incentives in play for management, the argument is that it is best to opt for

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[5] A Rappaport, 'The Staying Power of the Public Corporation' (1990) 68 Harvard Business Review 96, 100.

[6] D Kershaw, "The Foundations of the Business Judgment Rule in the United States," *The Foundations of Anglo-American Corporate Fiduciary Law* (Cambridge University Press 2018).

[7] JH Farrar, 'Business Judgement and Defensive Tactics in Hostile Takeover Bids' in JH Farrar (ed), *Takeovers: Institutional Investors and the Modernization of Corporate Laws* (Auckland, Oxford: OUP 1993).

[8] We are cognisant that the law in the United States can vary from state to state. However, it remains cohesive in the sense that there is no Takeover Code under federal [but there is the Securities Exchange Act as amended by the Williams Act that governs takeovers to a large extent] or state laws and that neither federal nor state laws prescribe a mandatory tender offer upon acquiring a certain percentage of share capital. State laws may vary on procedural matters such as voting, notice requirements and timing etc., but that does not impact the fundamental lack of a mandatory offer requirement, which is key to our analysis.

[9] Marcel Kahan, 'Jurisprudential and Transactional Developments in Takeovers' in Klaus J Hopt (ed), *Comparative* Corporate Governance: The State of the Art and Emerging Research (Clarendon Press 1998) 683, 685.

[10] Martin Lipton, 'Takeover Bids in the Target's Boardroom' (1979) 35 Business Lawyer 101, 114.

[11] *Revlon, Inc v MacAndrews & Forbes Holdings, Inc* 506 A 2d 173 (Del 1986); *Corwin v KKR Financial Holdings*, LLC, 125 A 3d 304 (2015). *Corwin* expanded the applicability of the business judgement rule to cases where previously the higher "entire fairness" standard was applicable (due to approving directors being interested or majority stockholder being on both sides of the transaction), so long as the merger was approved by a majority of fully informed, uncoerced stockholders.

[12] Frank H Easterbrook & Daniel R Fischel, 'The Proper Role of a Target's Management in Responding to a Tender Offer' (1980) 94 Harvard Law Review 1161, 1175.

managerial neutrality. This truncation of management power – and especially the prohibition of defensive measures by the board – emerged in large part as a reaction to the negative consequences of the business judgement rule, which had eroded managerial accountability to shareholders.[13]

To understand the risks with this approach, a cursory examination of the ownership patterns of corporations is necessary. In the United States, companies are predominantly widely held and professionally managed (though the former is becoming increasingly less true than it may appear at first blush).[14] On the other hand, in parts of continental Europe, East and South East Asia, and India, most listed companies are controlled by a single large shareholder or group of shareholders.[15] With concentrated shareholding comes a hands-on role in choosing the management and running the company actively. What diminishes is the agency problem between the majority shareholder and the management. What emerges, equally naturally, is the risk that the controlling shareholder may take decisions that are against the interests of the minority shareholders.[16] The expropriation of the minority by the majority is therefore becoming the dominant concern of markets all over the world, and it is a concern that cannot be remedied by hostile takeovers because of the concentrated shareholding structure of most of these companies.[17]

This concern of expropriation becomes magnified in the likelihood of a takeover. Offerors, preferring to keep acquisition costs low, may pay a premium to the controlling shareholder and exclude the minority, since they only really wish to induce the controlling shareholder to sell.[18] To make matters worse, minority shareholders may feel compelled to accept unattractive offers, thinking that if an acquisition goes through and the target is operated primarily for the benefit of the acquirer, earnings may be diverted away from it, and share prices may further plummet.[19]

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[13] Andrew Johnston, 'Takeover Regulation: Historical and Theoretical Perspectives on the City Code' (2007) 66 The Cambridge Law Journal 422.

[14] Clifford G Holderness, 'The Myth of Diffuse Ownership in the United States' (2009) 22(4) The Review of Financial Studies 1377.

[15] M Pagano & A Roell, 'The Choice of Stock Ownership Structure: Agency Costs, Monitoring, and the Decision to Go Public' (1998) 113(1) The Quarterly Journal of Economics 187, 188.

[16] R La Porta & ors, 'Investor Protection and Corporate Valuation' (2002) 57(3) The Journal of Finance 1147.

[17] R La Porta, F Lopez-de-Silanes, & A Shleifer, 'Corporate Ownership Around the World' (1999) 54(2) The Journal of Finance 471.

[18] Q Luo, Hui Li, & Biao Zhang 'Financing constraints and the cost of equity: Evidence on the moral hazard of the controlling shareholder' (2015) 36 International Review of Economics & Finance 99.

[19] This is an ostensibly valid concern and it will be addressed later in Section 2 by analysing the data on shareholder behaviour and target performance in companies that have been taken over.

Some argue that this is all very well since the objective of regulation must be the pursuit of corporate profits, not the equal treatment of shareholders,[20] and that paying a premium to the shareholder who is surrendering the controlling block of shares is not inherently unfair or unequal.[21] However, even if the objective of regulation is to create an environment that encourages companies to pursue increased profits, that cannot justify unrestrained inequality. Even if the controlling shareholder may be entitled to a premium, there ought to be rules around how much of a premium can be paid and when it is fair for it be paid. If the principles of maximization of corporate profits and the ease of conducting takeovers for offerors are to be taken to their natural conclusion, they may align to eliminate all protection for minority shareholders. This is a patently unfair outcome – a degree of protection is clearly required, particularly since markets with concentrated shareholding often do not have strong legal frameworks for corporate governance and minority protection. The protection of minority shareholders in such a situation is not only the 'right' choice but also the pragmatic one. It benefits the stability and growth of the securities markets (and consequently the economy more generally) by creating an environment where smaller retail shareholders are encouraged to invest. It also encourages smaller shareholders to invest in assets that yield better risk adjusted returns.

The question then before us is how to and how much to protect these minority shareholders, at the cost of other interests, and any attempt to answer that question must begin with examining the means of protection that exists in *status quo* – the Mandatory Bid Rule.[22]

The genesis of the Mandatory Bid Rule lies in the idea that a shareholder should have the right to exit the company if control of the company changes.[23] In its earliest form, it required those transferring effective control to not sell unless the buyer guaranteed that it would extend a comparable offer to all remaining shareholders. This meant a case-by-case determination of when effective control was being transferred and meant that the rule did not apply to market purchases.[24] Today, it means that once someone has acquired a sufficiently large stake in a company, they must make an open offer to acquire either an even larger one (a partial offer) or the entirety of the company (a

[20] George B Javaras, 'Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews' (1964) 32 The University of Chicago Law Review 420.

[21] Frank H Easterbrook & Daniel R Fischel, 'Corporate Control Transactions' (1981) 91 Yale Law Journal 698,716.

[22] The Mandatory Bid Rule is not the only measure which aims to protect minority shareholders, but it most certainly is the central one, necessitating in-depth analysis. An example of other provisions aimed at protection interests of minority shareholders are those on requiring disclosures – for instance, Regulation 29, 30 and 31 of the Takeover Code 2011. However, these do not merit a deeper dive here, since disclosure requirements don't bring with them the same kind of economic trade-offs that the MBR does.

[23] JH Farrar, *Farrar's Company Law* (4th edn, Butterworths 1998) 594.

[24] The Takeover Code 1968, r 10.

complete offer).[25] The same core considerations that applied to the rule then also apply now – to ensure that a controlling shareholder does not secure an inflated price without it being offered to other shareholders,[26] and to ensure a right of exit as downside protection in case a change in management leads to a negative change in value.[27] The trade-off is equally obvious – onerous takeover rules make control transactions expensive and time consuming, thereby reducing the number of such transactions. This is especially problematic in a market like India where, as we will argue later, control transactions should generally be facilitated if the controller is keen to exit.

B. Transplant of the MBR in India

Prior to the 1991 economic reforms, takeover activity was largely absent in India. This was mostly the result of two factors: the closed, public-enterprise dominated nature of the Indian economy, and the applicability of the Monopolies and Restrictive Trade Practices Act, 1969,[28] which allowed the Union Government to prevent acquisitions from going through if they caused concentration. Consequently, most of the activity during this period was that which was encouraged by the Government itself, such as the nationalisation of insurance companies and banks and the mergers of sick companies through the Board for Industrial and Financial Reconstruction (BIFR).[29]

As the economy gradually liberalised, stock exchanges started to regulate takeover activity through listing agreements.[30] Finally, in 1988, the Securities and Exchange Board of India was established and tasked with creating a regulatory framework for substantial acquisitions of shares. Rather than try to create a *sui generis* system, SEBI essentially evaluated the two most prominent systems present at the time – the market rule of the USA and the mandatory bid rule of the UK. It chose the latter, adapting it as best as it could to its own market conditions, the stage of economic development and the nature of different actors in its economy.[31] And so it was that the Takeover Code was enacted,

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[25] Edmund Schuster, 'Efficiency in Private Control Sales – The Case for Mandatory Bids' (2010) LSE Legal Studies Working Paper No 8/2010 <https://ssrn.com/abstract=1610259> accessed 18 April 2022.

[26] Clas Bergström, Peter Högfeldt, & Johan Molin, 'The Optimality of the Mandatory Bid Rule' (1997) 13(2) The Journal of Law, Economics, & Organization 433.

[27] BK Bhoi, 'Mergers and Acquisitions: An Indian Experience' (2000) 21(1) Reserve Bank of India Occasional Papers 133.

[28] *Ibid*.

[29] Dr Krishn Awatar Goyal & Mala Rathi, 'A Flashback of Mergers and Acquisition Trends in India' (2020) 13(4) Pacific Business Review International 177, 178.

[30] Umakanth Varottil, 'The Nature of the Market for Corporate Control in India' in Umakanth Varottil and Wai Yee Wan (eds), *Comparative Takeover Regulation: Global and Asian Perspectives* (Cambridge University Press 2017).

[31] Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, 'The Transplant Effect' (2003) 51 American Journal of Comparative Law 163; Umakanth Varottil, 'A Cautionary Tale of the

and India's regulatory regime built by transplanting English law.[32] At the time, it required a company which had acquired a 10% stake in a company to make an open offer to buy at least another 20%.[33] Today, multiple amendments later, those numbers stand at 25% and 26% respectively.[34]

In our attempt to go beyond the bare text of the regulation and understand its conceptual under pinning, we are aided mainly by three documents: the 1997 Bhagwati Committee Report on Takeovers,[35] the 2002 Report of the Reconvened Bhagwati Committee,[36] and the Report of the Takeover Regulations Advisory Committee 2010.[37] These reports explore both the rationale behind the original formulation of the rule and the justification for every amendment that has been made since.

Looking at these reports in conjunction, three things about the approach of the Committees stand out.

First, that despite extensive references to and borrowing from other jurisdictions, there was either no principled framework put in place to guide this process of legal transplantation,[38] or such a framework was put in place but not entirely applied. These contrasting problems are well understood by looking at the work done by the 2010 and 1997 committees respectively.

The 2010 committee considered provisions regarding the mandatory bid threshold,[39] market price based parameters for frequently traded shares,[40] look back periods,[41] non-compete fees,[42] trigger for indirect acquisitions,[43] withdrawal of open offer,[44] and recommendations by independent directors of target company from a variety of jurisdictions.[45] In each of these sections, the

Transplant effect on Indian Corporate Governance', (2009) 21(1) National Law School of India Review 1.

[32] Umakanth Varottil, 'The Evolution of Corporate Law in Post-Colonial India: From Transplant to Autochthony' (2016) 31 American University International Law Review 253.

[33] (Substantial Acquisition of Shares and Takeovers) Regulations 1997, Reg 10(1), Reg 21(1).

[34] (Substantial Acquisition of Shares and Takeovers) Regulations 2011, Reg 3(1), Reg 7(1).

[35] Securities and Exchange Board of India, *Justice PN Bhagwati Committee Report on Takeovers* (1997) (1997 Bhagwati Report).

[36] Securities and Exchange Board of India, *Report of the Reconvened Committee on Substantial Acquisition of Shares and Takeovers Under the Chairmanship of Justice PN Bhagwati* (2002) (2002 Bhagwati Report).

[37] Securities and Exchange Board of India, *Report of the Takeover Regulations Advisory Committee Under the Chairmanship of Mr C Achuthan*, (2010) (2010 TRAC Report).

[38] The term transplantation has been used as shorthand here; equally, terms like migration, circulation, or diffusion could have been used.

[39] 2010 TRAC Report, pts 2(1.4), and 2(2.5).

[40] 2010 TRAC Report, pt 2(4.7).

[41] 2010 TRAC Report, pt 2(4.8).

[42] 2010 TRAC Report, pt 2(4.9).

[43] 2010 TRAC Report, pt 2(5.0).

[44] 2010 TRAC Report, pt 2(6.0).

[45] 2010 TRAC Report, pt 2(13.0).

approach of the committee was to state the different rules in other jurisdictions without critically evaluating them, the principles underpinning them, or their impact in the context of that jurisdiction. Although thorough, the approach lacks a cohesive understanding of what the basis of a transplant should be, as well as how that transplant will both affect and be affected by the Indian legal system. Admittedly, there exist divergent approaches to the issue of methodologies of transplant– for instance, everything from Teubner's idea of transplants as irritants that send ripple effects in the legal system they're being imported into,[46] to Frankenberg's appeal for re-examining the frames of reference used for comparison, to avoid ethnocentric biases,[47] might have been relevant– and no single methodology is perfect.

The 1997 committee, on the other hand, clarified that instead of focusing on the "procedures, regulatory requirements and various quantitative limits" in each jurisdiction, it was more important to look at the reasons behind why each of these were chosen in their context.[48] The attempt, then, was presumably to undertake a study of what Ewald terms "law in minds"[49] – the principles, concepts, beliefs, and reasoning that underpin foreign legal rules and institutions – and consequently import those that were compatible with our own. The framework itself is an appealing one, although it is debatable whether it was entirely applied. For instance, the Committee located "equality of opportunity to all shareholders, protection of minority interests, transparency and fairness" as the common principles in most countries.[50] It then imported them into the Indian legal system by virtue of their general prevalence, rather than by assessing how compatible these principles were with Indian market conditions or exploring how the possible tension between those principles could be treated.

Second, and perhaps linked to the absence of a framework guiding the process of legal transplantation, none of the Committees explained how they chose the jurisdictions they would use for comparison and transplant, as well as the respective relevance of each jurisdiction chosen. This critique does not come only from a desire for methodological clarity. After all, which jurisdictions you use as a frame of reference affects, in very real ways, what your domestic law ends up being.

One example of the repercussions of this seemingly chance selection of jurisdictions is with reference to the Committees' decisions on open offer sizes.

[46] Gunther Teubner, 'Legal Irritants: Good Faith in British Law or how Unifying Law ends up in New Divergences', (1998) 61(1) The Modern Law Review 11.

[47] Gunter Frankenberg, 'Critical Comparisons: Re-thinking Comparative Law' (1985) 26 Harv Int'l L J 411.

[48] 1997 Bhagwati Committee Report, Preface, para 13.

[49] William Ewald, 'What was it like to try a Rat?' (1995) 143 University of Pennsylvania Law Review 1889.

[50] 1997 Bhagwati Committee Report, Preface, para 13.

The 1997 Report uses the mandatory open offer sizes in UK, USA, Singapore and Hong Kong as equally relevant comparative examples, ignoring the basic difference in consequences due to the concentrated shareholding in Singapore and Hong Kong compared to the dispersed pattern in UK and USA.[51] The 2010 Report continues to select jurisdictions at random, seemingly ignoring some which could be good comparatives. For instance, the report gives the stark recommendation that the size of the open offer in the case of a mandatory bid be increased to 100%. Yet, it does not consider the South Korean experience, perhaps the most compelling counter-point to this recommendation at the time. South Korea had a 5% tender offer rule for off-market transactions, which it later discarded in the favour of an MBR very similar to India in 1997.[52] Noting that such an MBR was hindering even friendly transactions, it was revoked just a year later in 1998.[53] South Korea may be an outlier, but the fact of it being a concentrated shareholding jurisdiction with corporate structures comparable to India[54] could have helped the TRAC determine the likelihood of similar consequences in India. Unfortunately, this was not done. This is but one example – the general point is that it seems a more careful inspection of jurisdictions could have improved the comparative analysis undertaken in the Committee reports.

Third, the choice of the open offer size seems to not be consistent with the Committees' own observations about the limited nature of financing available in the Indian market.

As per the 1997 report, a 10% shareholding was considered sufficient to indicate that control over a company was being sought owing to the nascent nature of the market for corporate control, and the presence of concentrated shareholding. The lack of robust financial institutions to fund acquisitions, however, made the Committee comment that imposing a high minimum offer size above and beyond this initial 10% was likely to hinder acquisitions. Despite this, perplexingly, the Committee suggested a minimum mandatory offer limit of 20% beyond the initial 10% acquisition– twice the number considered adequate to gain control, and hence certain to hinder acquisitions. The 2011 TRAC report went much further, suggesting increasing the open offer size to 100%, despite 89% of the open offers in the past four years being undersubscribed. This in spite of the fact that the Committees' earlier concerns

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[51] Umakanth Varottil & Wai Yee Wan, 'The Divergent Designs of Mandatory Takeovers in Asia' (2022) 55 Vanderbit Journal of Transnational Law 89; NUS Law Working Paper No. 2021/011, European Corporate Governance Institute - Law Working Paper No. 592/2021, <https://ssrn.com/abstract=3858227> accessed 18 April 2022.

[52] Young-Cheol K Jeong, 'Hostile Takeovers in Korea: Turning Point or Sticking Point in Policy Direction?' (2010) 18 Asia Pacific Law Review 113, 120;

[53] *Ibid.*

[54] Il Chong Nam & ors, 'Corporate Governance in Korea' (OECD Conference on Corporate Governance in Asia: A Comparative Perspective, March 1999) para 35 <https://www.oecd.org/corporate/ca/corporategovernanceprinciples/1931564.pdf> accessed 18 April 2022.

regarding the difficulty of funding takeovers had not been resolved on the contrary, a combination of regulatory restrictions on financing, high interest rates, and corporate benefit restrictions preventing companies from financing share acquisitions, meant that the financing of acquisitions remains difficult to this date.

However, none of these represent the most fundamental error made by the Committees. Their most fundamental error lies in their articulation of the core objective of takeover regulation.

III. SEEKING A NEW OBJECTIVE FOR TAKEOVER REGULATION

There is a lack of clarity and consistency in all three reports published by the committees with regard to the core objective of takeover regulation.

The first report begins by identifying in its preface that takeovers are an important tool for ensuring the growth of wealth in the economy.[55] A few pages later, seemingly at variance with this observation, it states that takeover regulation should be indifferent to the commercial advantages and disadvantages of takeovers.[56] Having thus taken both sides, this report finally rejects commercial efficiency completely.[57] This confusion, however, re-emerges in the preface of the 2010 report, which lists nine different objectives, including the interests of investors, and claims that all of them must be achieved with little guidance as to what should be done in situations where they conflict, other than to state that the interests of shareholders must be protected.[58] The report also says, though, that these interests must be provided by securing for them a right of exit in all circumstances – indicative, again, of a deprioritisation of commercial efficiency, since obviously a right of exit increases the cost of takeovers.[59]

What exactly, then, is prioritized? The first report speaks of fair and equal treatment of shareholders;[60] the second, of equal treatment of shareholders;[61] the third, of fair treatment of shareholders.[62] These are not synonymous terms, but they have been treated synonymously, ignoring the fact that a fair outcome may not be achieved through equal treatment. Equality is not equity.

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[55] 1997 Bhagwati Committee Report, Preface, para 4.

[56] *Ibid*, pt 1(1.1).

[57] *Ibid* pt 1(1.1).

[58] 2010 TRAC Report, Preface, para 9.

[59] *Ibid* Preface, para 12(d), pt 2 (1.10).

[60] 1997 Bhagwati Committee Report, pt 1 (1.1).

[61] 2002 Bhagwati Committee Report, para 3.1.

[62] 2010 TRAC Report, pt 2(1.10).

At the very least, though, the literature is sufficient to allow us to conclude that the objective of choice was that of either fair or equal treatment of shareholders, and the Code assumes that this can be secured only by allowing shareholders a right of exit. In this section, we seek to demonstrate that this understanding was incorrect, premised as it was on a false dichotomy between the fair treatment of shareholders and commercial efficiency. We posit that shareholder interests and the promotion of commercial efficiency are actually aligned, and that a need to provide for shareholder exit shouldn't be framed in the context of protection, but rather an opportunity to promote fairness through, *inter alia,* sharing of extraordinary gains that may accrue in specific circumstances. With that premise, the regulation can be framed with greater consistency and clarity and hope to achieve more balanced outcomes.

To further this claim, *first* we articulate the triggers for takeovers in the Indian market. Given the nature of concentrated family-owned shareholding structures in Indian companies, a control transaction will almost always be friendly. In other words, it will often be seller driven and not buyer driven (unlike in the US, UK and other dispersed shareholding markets where it can often be buyer driven i.e., hostile). Sellers are either driven by a need (distress, liquidity, family dispute, inability to grow) or an opportunity (attractive price). We postulate that where any of those circumstances exist, a company (and consequently, every shareholder's interests) is likely to be better served if the takeover is concluded. Most transactions will be for good reason and should therefore be facilitated. The Mandatory Bid Rule increases the cost of a takeover significantly, and therefore also increases the probability of a takeover not happening, particularly in India, given the barriers on account of significant financing and regulatory constraints. Consequently, rather than protecting minority shareholders, the MBR is harming their interests by deterring takeovers that are good for both the company and the shareholder.

Second, we attempt to establish that for all the Committees' claims about protecting shareholders by securing their right to exit, shareholder conduct makes clear that this is not a right that they want to exercise. Most shareholders choose to not exit in the event of a takeover. This is an implicit endorsement by shareholders of the idea that takeovers are positive events, not negative ones. Consequently, it would be reasonable to conclude that shareholders would not be particularly concerned by the removal or dilution of a right to exit in the event of a takeover.

Third, we seek to demonstrate empirically that this endorsement is not without reason – an analysis of share prices of companies before and after takeovers shows that there is a clear trend of share prices increasing after a takeover. Shareholders, then, can clearly choose to exit later and secure a fair price if they so choose – there is no real benefit in securing the right to exit at the time of the takeover.

Fourth, we try to demonstrate that, in practice, even in the cases where companies fail to improve performance after a takeover, the MBR is not a useful tool for the protection of shareholders, as it does not alter shareholder behaviour any differently from the average in such cases.

Fifth, we respond to the argument (based on logic and not evidence) that the only reason takeovers are empirically good events is that the MBR is filtering out 'bad' takeovers and only allowing 'good' takeovers to occur.

Sixth, taking all of this into consideration, we re-think what the objective of takeover regulation in India should be.

We use both theoretical and empirical analyses in the process of making our claim. Our empirical analysis looks at available data on all recent open offers. We use the SEBI website as our primary source. At the time of writing of this article, it had 331 open offers on record between 2015 and 2022. For these open offers, corresponding data on subscription percentages, and share prices has then been taken from the BSE Limited website. All the data is available for readers to peruse here.[63] The data was collected and corroborated by two persons independently to maintain its accuracy. Points where any corresponding data was unavailable from a reliable source were specifically excluded from the data set.

A. When Do Takeovers Happen in India?

Traditional theories for why companies engage in takeovers explain them as measures which enhance efficiency, aid corporate expansion and diversification, increase concentration or monopolies, or respond to macroeconomic changes such as technological shocks or significant changes in economic regulation.[64] This lens is conspicuously buyer-centric – and in mature market economies like the UK or the US, with dispersed shareholdings, professional managements, and a developed financing market,[65] such a lens makes sense since the buyer often initiates the takeover more often than the seller does.

However, India is a primarily promoter-led, concentrated-holding jurisdiction with an absent share financing market.[66] Even though there has been a rise in the role of institutional shareholders, private equity and venture capital in the recent years, the average shareholding of promoters of all listed companies

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[63] The data is available here: <http://drive.google.com/uc?id=1q1pyVipD2dkTiLUPZ5Kg9WTS-j0mHp9yl> accessed 23 July 2022.

[64] PL Beena, 'Trends and Perspectives on Corporate Mergers in Contemporary India', (2008) 43(39) Economic and Political Weekly, 48; B Espen Eckbo, 'Corporate Takeovers and Economic Efficiency', (2014) 6 Annual Review of Financial Economics 51.

[65] Deborah A DeMott, 'Comparative Dimensions of Takeover Regulation' (1987) 65 Washington University Law Quarterly 69

[66] Varottil (n 32).

in India has remained fairly stable at around 50% since 2001.[67] Further, in our data set of 321 open offers for which the shareholding pattern of the target was available, 64% of the companies had promoter shareholding of 50% or greater. 27% had promoter shareholding of between 25-50% and only 9% of the companies had promoter shareholding of below 25%, which is the threshold for negative control via the ability to block super majority resolutions (See *Chart 1* below).

Thus, whilst buyers may have a keenness on an acquisition, nothing is likely to happen unless the seller is interested and determined to make it happen.[68] Consequently, we suggest that the lens of analysis for takeovers in India must shift to the actions of the seller. We must therefore ask ourselves - what circumstances trigger a promoter in India relinquishing control of the company? On reviewing the takeovers that have occurred in India over the last few years,[69] we were able to identify three common, non-mutually exclusive circumstances. This is an indicative and not exhaustive list and is supported by some examples from prominent takeovers below.

The first circumstance is where the promoter is impelled to sell its stake for reasons external to the company itself. A case in point is of the sale of Shree Renuka Sugars, sold in order to reduce increasing debt caused by losses in two group companies in Brazil.[70]

The second circumstance is where the promoter recognizes a change of control is necessary to tap into the company's potential. The company might just need an acquirer with greater resources, such as in the takeover of Just Dial by Reliance Retail.[71] Alternatively, the promoters may be distracted from running

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[67] OECD, 'Ownership Structures of Listed Companies in India' (2020) <https://www.oecd.org/corporate/ownership-structure-listed-companies-india.pdf> accessed 23 July 2022.

[68] We recognize that hostile takeovers are not impossible even in India, as was demonstrated when L&T acquired Mindtree. While Mindtree is in our dataset, we do not specifically analyse that case separately in this article since we recognize that the Mandatory Bid Rule is inherently unable to protect promoters in a widely held company like Mindtree if the institutional investors seek an exit. As has been said before, the biggest protection which deters hostile takeovers in India is the concentrated shareholding pattern. The Mindtree takeover is not an indicator of any growing trend of hostile takeovers as an overwhelming majority of listed companies are still concentratedly held. Nonetheless, we would like to point out that in this exceptional case where the institutional investors facilitated a hostile takeover, Mindtree has performed exceptionally well commercially subsequent to the takeover.

[69] The data is available here: <http://drive.google.com/uc?id=1q1pyVipD2dkTiLUPZ5Kg9WTS-j0mHp9yl>.

[70] Ajay Modi, 'Behind Narendra Murkumbi Selling Stake in Shree Renuka Sugars' (*Business Today,* 30 March 2014) <https://www.businesstoday.in/latest/corporate/story/brazilian-buys-narendra-murkumbi-sell-stake-shree-renuka-sugars-133295-2014-03-20> accessed 18 April 2022; Ranjani Ragahvan, 'Singapore's Wilmar Hiking Stake in Debt-laden Top Sugar Producer Shree Renuka' (*VC Circle,* 28 July 2017) <https://www.vccircle.com/singapores-wilmar-hiking-stake-in-debt-laden-top-sugar-producer-shree-renuka> accessed 18 April 2022.

[71] Indulal PM & Arijit Barman, 'Reliance goes Shopping again, Discovers Just Dial, Acquires Controlling Stake in $700-million Deal' (*The Economic Times*, 16 July 2021) <https://

the company, whether that be because of the presence of a family dispute, the absence of a clear successor, or even a simple lack of interest, such as in the case of Indiabulls.[72] A takeover would then be almost necessary to ensure that the value of the company is preserved and all stakeholders (particularly minority shareholders) are thereby protected.

The third circumstance is where the promoter is encouraged to sell by the offer of an attractive price. One example is the acquisition of Healthcare Global Limited by CVC Capital, where the offer price represented a 33% premium over the average share price in the market.[73]

The common thread running through all three situations is that a takeover is likely not a negative event for the company. It is often a markedly positive one. In the time since the takeover, Just Dial's performance has improved markedly, India bulls has grown significantly, and both Shree Renuka Sugars[74] and Healthcare Global Limited have seen their share price more than double.[75] Admittedly, this analysis is anecdotal in nature – to make a less speculative claim would require knowledge about the inner working of takeovers that is not entirely in the public domain. But assuming this proposed taxonomy is not too far off the mark, it seems reasonable to say that in most cases where a takeover happens, the takeover is either important for the company's continued good health (such as when the promoter has lost interest) or at the very least likely to not be a net negative (even when the promoter is exiting for an attractive price and the company was otherwise in good health, the mere payment of an attractive price is a strong indicator of genuine interest and deep capital reserves on the part of the buyer – the company should thus continue to fare well).

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economictimes.indiatimes.com/industry/services/retail/reliance-goes-shopping-again-discov- ers-just-dial-buys-it-for-rs-3497-crore/articleshow/84476506.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst> accessed 18 April 2022; Press Trust of India, 'Reliance Retail Ventures Acquires Sole Control of Just Dial' (*Business Standard,* 2 September 2021) <https://www.business-standard.com/article/companies/reliance-retail-ventures-acquires-sole-control-of-just-dial-121090201180_1.html> accessed 18 April 2022.

[72] PTI, 'Indiabulls Housing Fin promoter Sells 12% Stake to Make it Professionally Managed Firm' (*The Economic Times,* 17 September 2021) <https://economictimes.indiatimes.com/markets/stocks/news/indiabulls-housing-fin-promoter-sells-12-stake-to-make-it-professionally-managed-firm/articleshow/88327023.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst> accessed 18 April 2022.

[73] ET Bureau, 'CVC Capital to Buy Cancer Chain HCG for Rs 1,049 Crore' (*The Economic Times,* 4 June 2020) <https://economictimes.indiatimes.com/markets/stocks/news/cvc-capital- to-buy-cancer-chain-hcg-for-rs-1049-crore/articleshow/76190987.cms?from=mdr> accessed 18 April 2022.

[74] BSE Limited, 'Stock Prices Shree Renuka Sugars' <https://www.bseindia.com/markets/equity/EQReports/StockPrcHistori.aspx?expandable=7&scripcode=532670&flag=sp&Submit=G> accessed 18 April 2022.

[75] BSE Limited, 'Stock Prices Healthcare Global Limited' <https://www.bseindia.com/markets/equity/EQReports/StockPrcHistori.aspx?expandable=7&scripcode=539787&flag=sp&Submit=G > accessed 18 April 2022.

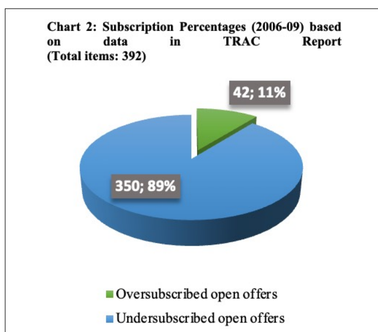
In addition to the takeovers that we identified, doubtless there are also those that fell through owing to a lack of sufficient financing, thereby hurting both the company and its minority shareholders. Consequently, the interests of the acquirer, seller, and shareholders are seemingly aligned – the only way for them to converge is to facilitate, not discourage, takeovers. The MBR, which secures shareholders an exit they may not particularly need, at the cost of deterring takeovers that may in fact be necessary for promoting their financial interests, appears to be ill-founded.

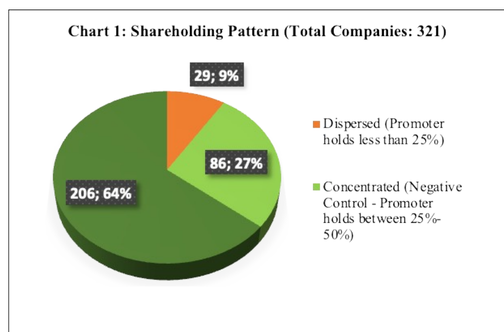
B. Do Minority Shareholders Want to Leave?

We must consider, however, what minority shareholders want separately from what we believe they need. Certainly, as per our hypothesis they don't need the right to exit, especially at the cost of takeovers being precluded. However, if they nonetheless overwhelmingly prefer having that right despite its concomitant cost, then that preference should at least be considered and examined.

To determine whether such a preference exists, we examine subscription rates on open offers. If open offers for takeovers are generally over subscribed, it becomes clear that minority shareholders do want the right to exit; if they are under subscribed, the opposite will hold true.

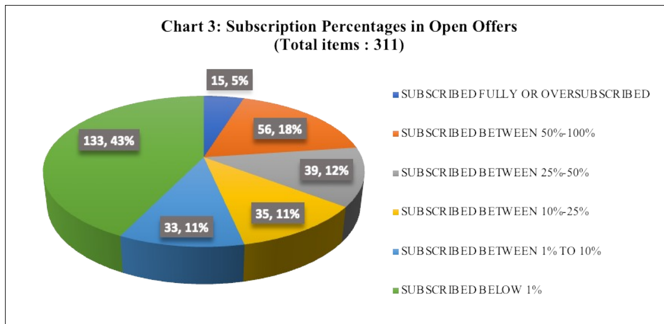
The data contained in the TRAC Report (See *Chart 2*), released in 2010, is helpful in this regard. In the previous four years, only 42 of 392 open offers, had been fully subscribed or oversubscribed – a mere 10.7%. The remaining 89.3% were under subscribed, a strong endorsement of the view that shareholders do not for the most part seek an exit.





However, decade-old data, while relevant, is not sufficient to make the point, since preferences can change over time.

Therefore, we analysed the data set of 331 open offers to understand whether this trend of under subscription has continued. We were able to find subscription rates for 311 of them on the BSE Limited website; these 311 therefore comprise our complete dataset.[76]



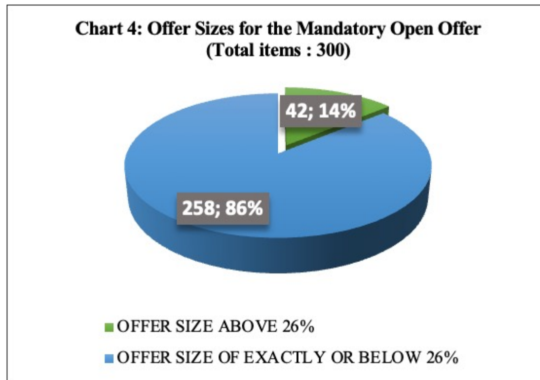
Our findings are revealing (*Chart 3* above). Out of 311 open offers, only 5% were fully subscribed or oversubscribed. Perhaps even more remarkably, 43% received under one-percent subscription. The average subscription rate – which tells us of how much of an open offer gets accepted – is a mere 26.6%.

The size of the open offers, on the other hand, is overwhelmingly the statutory minimum – 86% of open offers are for the acquisition of an additional 26% shareholding. Looking at these two factors in conjunction, in most cases the percentage of total public shareholders seeking an exit comes out to be a minuscule 7%.[77]

It seems clear that shareholders largely do not see takeovers as negative events, and do not have a preference for being provided with the right of exit. In fact, a significant majority of shareholders choose to remain.

[76] Takeover database (n 69).

[77] The fact that, on an average, such a low number of shares is actually tendered to the buyer also indicates that the acquirer is clearly not always looking to acquire 51%; actual control may be reached with a much lower threshold. This serves to clarify that the increased financial burden that comes with the MBR is in fact additional; parties would not always be looking to acquire a minimum of 51% at the moment of the takeover irrespective of the MBR.



C. Empirically, should Minority Shareholders want to leave?

It may be reasonably argued that shareholders might simply be mistaken, and that their seeming rejection of the right to exit is therefore misplaced. If that were to be true, then irrespective of what shareholders want, the regulator could choose to act as a watchful guardian and secure the right of exit for them anyway. For such a choice to be justifiable, however, especially in light of our earlier analysis on why takeovers are likely to be good for shareholders, the regulator should seek out concrete empirical evidence demonstrating that shareholders will actually suffer if not provided the right to exit at the time of the takeover.

The only way to analyze whether shareholders will be harmed if not provided the right to exit at the time of a takeover, is by examining the share price performance of companies before and after the takeover. If a takeover is immediately followed by a reasonable dip in share price, then it could be argued that shareholders were harmed by not being provided the right to exit.

We use absolute share price as a metric to assess company performance for three reasons. First, because the share price is meant to reflect all the available information about the company's performance and prospects, at least in a perfect market.[78] No market is perfect; however, even in an imperfect market with information asymmetry, it is difficult to locate another metric which incorporates as much information as the share price would. Second, the profits and losses of public shareholders can be directly measured through the share price, as it is the amount they realize when they exit the company. Although it would be useful to have relative performance, (benchmarked against peers and not the index)in addition to absolute performance, this is not always possible or useful in India given the lack of depth in public markets. In any event, our approach,

[78] Michael Firth, 'The Profitability of Takeovers and Mergers' (1979) 89(354) The Economic Journal 316.

which uses a combination of the different time periods in which takeovers occurred and the significant sample size of targets, does in our opinion, provide a credible basis for drawing the conclusions with regard to the trends that we have observed.

All of this makes share price the best metric, despite its susceptibility to fluctuations due to market events, externalities or information leaks.[79] Our data set comprised the 331 open offers we mentioned earlier, and we used SEBI itself and BSE Limited to find reliable share price and offer price information. We use the following variables:

Y0: Share price at the end of the year prior to the takeover.

Y1: Share price at the end of the year of the takeover.

Y2: Share price at the end of the year subsequent to the takeover.

P: Tender offer price per share for the mandatory bid under the Takeover Regulations.

Using these variables, we conduct our analysis on the following two axes:

a) *Comparison with Y0:* First, to analyse whether a takeover is good for the company, we ascertain whether share prices increased or decreased subsequent to a takeover. Therefore, we calculated the percentage change in *Y1* and *Y2* compared to Y0.

- % Change in *Y1* over *Y0* =
- % Change in *Y2* over *Y0*=

b) *Comparison with P:* Second, to analyse whether or not the shareholders benefit from the exit via tender offer provided by the MBR, we ascertain whether the tender offer price is superior to the share prices in subsequent years. Therefore, we calculate the percentage change in *Y1* and *Y2* compared to P.

- % Change in *Y1* over *P* =
- % Change in *Y2* over *P* =

We conduct our analysis on *Y1* and *Y2* because the immediate short-term impact of the takeover is relevant from the perspective of the minority's decision to exit the company, even when some effects of decisions of the new management may be visible in the more medium-term. Additionally, this focus on

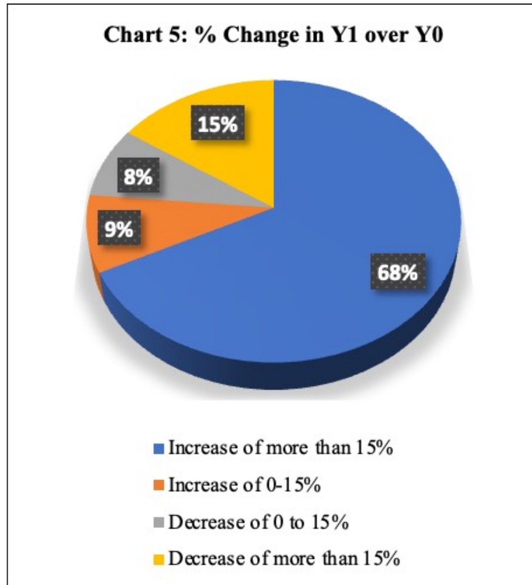
[79] *Ibid*.

the shorter term means fewer externalities influence the data. Further, while we were cognizant of the possibility of the COVID-19 pandemic complicating our analysis, the general trends which we observed in the 2015-2019 period continued through 2019-2022 as well. Consequently, we feel comfortable including those takeovers in our data set.

Our findings are as follows:

1. Comparison with *Y0*

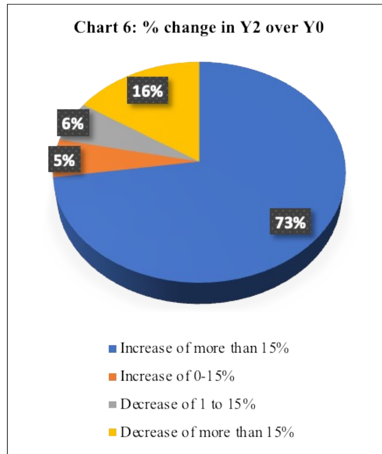
(i) % Change in *Y1* over *Y0* (See *Chart 5* and corresponding table below)



% Change of *Y1* over *Y0*	
	No. of Takeovers
Total Takeovers in List	331
Total Takeovers for which information is available	271
Increase of more than 15%	184
Increase of 1-15%	24
Decrease of 1 to 15%	22
Decrease of more than 15%	432

The total instances in this data set are 271. *Y1* increased over *Y0* in 76% of all cases and fell only in 16%. In totality, the average change in *Y1* was an

increase of 141.2% - indicating that at the end of the year when the takeover happened, share prices had more than doubled.



% Change in Y2 over Y0	
	No. of Takeovers
Total Takeovers in List	331
Total Takeovers for which information is available	253
Increase of more than 15%	184
Increase of 1-15%	14
Decrease of 1 to 15%	15
Decrease of more than 15%	40

(ii) % Change in *Y2* over *Y0* (See *Chart 6* and corresponding table below)

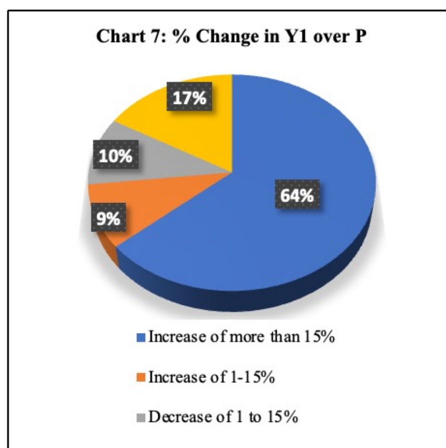
The total instances in this data set are 253. *Y2* increased over *Y0* in 78% of all cases and fell significantly in a mere 16%. In totality, the average change in *Y2* over *Y0* was an increase of 249.94% - essentially, a year after the takeover, companies' share prices had more than tripled.

The results speak for themselves – clearly, company share prices generally see significant growth in the years subsequent to the takeover (far more significant than the growth they see in the year immediately prior to the takeover, which averaged 49.7%).[80] Thus, in a large majority of cases, shareholders need not exit due to worries about company performance. Rather, they stand to make significant gains if they choose to remain in the company.

[80] The data is available here: <http://drive.google.com/uc?id=1q1pyVipD2dkTiLUPZ5Kg9WTS-j0mHp9yl>.

2. Comparison with *P*

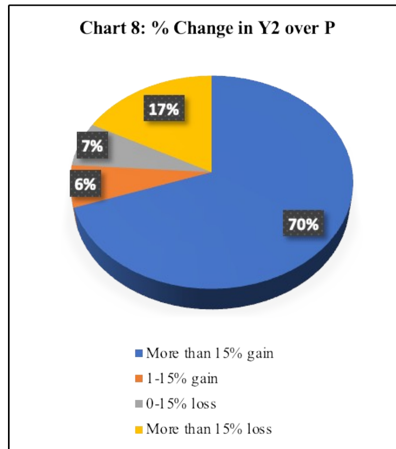
(i) % Change in *Y1* over *P* (See *Chart 7* and corresponding table below)



% Change in *Y1* over P	
	No. of Takeovers
Total Takeovers in List	331
Total Takeovers for which information is available	295
Increase of more than 15%	188
Increase of 1-15%	28
Decrease of 1 to 15%	30
Decrease of more than 15%	49

The total instances in this data set are 295. *Y1* increased over *P* in 72% of all cases and fell only in 17%. In totality, the average change in *Y1* was an increase of 158.6% - indicating that by the end of the year when the takeover happened, share prices had more than doubled relative to offer price.

(ii) % Change in *Y2* over *P* (See *Chart 8* and corresponding table below)



% Change in *Y2* over *P*	
	No. of Takeovers
Total Takeovers in List	331
Total Takeovers for which information is available	284
Increase of more than 15%	198
Increase of 1-15%	18
Decrease of 1 to 15%	19
Decrease of more than 15%	49

The total instances in this data set are 284. *Y2* increased over *P* in 76% of all cases and fell in a mere 17%. In totality, the average change in *Y2* over *P* was an increase of 242.4% - essentially, a year after the takeover, companies' share prices had more than tripled.

The results above clearly indicate that, in most cases, the exit at tender offer price is not a good deal for the shareholders. This is because share price at the end of *Y1* and *Y2* shows significant increase over the offer price. Thus, if the aim of the exit via tender offer is to provide protection through profit sharing, it is a misplaced one – and the shareholders, in most cases, are better off not accepting it.

D. Does the right of exit protect shareholders in the case of bad takeovers?

At this juncture, three things seem apparent:

- it is crucial for the sake of both the target company and the shareholders that takeovers in the Indian market not be made any more onerous than is necessary;
- an MBR makes takeovers more onerous by significantly increasing their cost; and,
- shareholders anyway do not generally exercise the right to exit that comes with the MBR.

For the most part, the evidence supports the idea that eliminating the open offer requirement can promote the efficiency of the market for corporate control while also better serving shareholders' interests.

What, though, of the small number of instances (17%) in which shareholders are worse off after a takeover? We must at least consider the possibility that the MBR protects shareholders in those cases where the share price falls significantly. We have taken a 15% price reduction after the takeover as a baseline, even though a 15% reduction may very well be no more than a minor fluctuation. In order to conclude that the MBR provides adequate protection in these cases, the data must indicate that it is enabling shareholder exit at a markedly higher rate in those cases where the value of a company is going to decrease as compared to other cases. If it is not, and shareholders exit at approximately similar rates when targets end up improving their performance as when they end up worsening it, then the MBR provides only *de jure* protection with no real value.

To assess this, we compared subscription rates overall to subscription rates in the case of those companies where the value decreased post-takeover, to see if there existed a substantial difference.

As mentioned earlier, the average subscription rate over the 311 takeovers for which reliable data was available was 26.58%. When focusing instead on only those 49 takeovers which were accompanied by an over 15% decrease in share value by *Y2* compared to *P* (i.e., 'bad' takeovers where the shareholders would have been demonstrably better off had they opted for an exit), the average subscription rate rose to 33.81% – a marginal increase, true, but far from being significant enough to infer a causal link. Similarly, when using the alternate metric of how many open offers were fully or over-subscribed, there is once again barely any difference – approximately 5% of all open offers were fully or over-subscribed, while approximately 8.6% of open offers made in the case of the aforementioned 49 'bad' takeovers were fully or over-subscribed. Not only is the difference marginal, but the percentage of open offers fully or over-subscribed in the case of these 'bad' takeovers is also in itself remarkably low.

Based on these results, there is certainly not enough evidence to suggest that the mandatory bid rule functions as any kind of fail-safe protecting minority shareholders in the case of 'bad' takeovers.

A possible counterargument to the above is that the under subscription may be a consequence of the pricing of the open offer, and not necessarily as a failure of the MBR – and so, the solution might lie in reworking the pricing norms instead. For this to work, the price would need to be adjusted meaningfully, since some shareholders will choose to stay and evaluate the performance of the target under new ownership and management.

Any meaningful adjustment to the price will increase the cost of the acquisition. This cost needs to be weighed against any potential benefits that might accrue to some shareholders who will choose to exit. Even then, over time, exiting shareholders might realise that they are better off staying instead of leaving if it is established that the target is likely to deliver better returns than the increased offer price.

Thus, changing pricing rules to artificially seek an even higher price, in order to enhance subscription will likely be counterproductive, as it will increase acquisition cost and reduce the number of takeovers.[81]

E. Is the MBR responsible for filtering out bad takeovers?

There remains one additional reservation to be addressed – what if the only reason takeovers are having an overwhelmingly positive effect is that the entry barrier created by the MBR is filtering out bad takeovers? We are relying on data to show that the MBR is counter-productive; what if instead all it demonstrates is that the MBR is meeting its core objective? To this reservation we have three responses.

First, the only clear takeaway from the data is that takeovers are positively correlated with share performance. There is nothing to indicate that the MBR has caused this to happen. In fact, it is possible that it actually filtered out several good transactions. After all, an expensive and time-consuming process is bound to act as a deterrence to a reasonable buyer looking for value. In the

[81] SEBI, 'Review of determination of Offer Price in case of disinvestment of PSU Companies: Consultation Paper', (25 March 2022) <https://www.sebi.gov.in/reports-and-statistics/reports/ mar-2022/review-of-determination-of-offer-price-in-case-of-disinvestment-of-psu-companies_57186.html> accessed 18 April 2022. SEBI themselves have noted the rise in prices when information comes into the public domain. Most recently, they have suggested that the 60-days volume weighted average price parameter be done away with in the case of Public Sector Undertaking disinvestments as, unlike private transactions, a significant amount of time passes between cabinet approval and execution of the final agreement for such transactions. During this period, the share price may continue to rise increasing the burden on the acquirer and potentially defeating the transaction.

absence of evidence one way or the other, to presume that the MBR had a positive role to play would be a mistake.[82]

Second, unlike in the UK, where the 100% MBR may act as a deterrent for buyers when they try to undertake 'bad' hostile acquisitions – and therefore, may help select the value accretive and synergy-creating takeovers – in India, the overwhelming majority of takeovers are at the behest of the seller. Consequently, the takeovers that the MBR is precluding are likelier to be good ones than bad, for the reason, as explained earlier, that it is beneficial to promote transactions that are seller driven in a concentrated shareholding market with weak governance controls.

Third, as a matter of fact, some 'bad' takeovers continue to occur despite the existence of the MBR.

This should be sufficient to demonstrate that it is far likelier that the value accretion due to takeovers in India is an outcome of the structure of the market than of the MBR. Most takeovers see the interests of the seller, buyer and the minority shareholders align. In such an environment, the MBR only acts as a hindrance to good takeovers.

F. What objective should we pursue?

Based on the examination of the available data, we posit that the objective of providing fair and/or equal treatment to shareholders in a control transaction, by securing for them a right of exit at all times is an ill-advised one.

Takeovers in India are generally value accretive. This efficiency is empirically demonstrable through the increase in share prices in a large majority of cases. The public shareholders generally benefit from remaining in the company to enjoy the profits, and most choose to remain. This is demonstrable through the extremely low subscription rates to open offers, even when prices tend to rise when takeover information invariably reaches the public domain prior to the launch of an offer.

Admittedly, there are some cases where takeovers lead to a value erosion for the shareholders. However, since subscription rates are mostly constant across takeovers regardless of whether they lead to significant gains and losses, it is clear that shareholders cannot effectively assess at the open offer stage which these takeovers are. Consequently, the MBR cannot solve this problem; all it accomplishes is decrease the probability of all takeovers occurring, which is an unwanted outcome for all stakeholders. Consequently, the choice of the MBR

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[82] Alan Baker, 'Simplicity' (*The Stanford Encyclopedia of Philosophy*, 2022) <https://plato.stanford.edu/entries/simplicity/> accessed 18 April 2022.

as a default rule is no longer principally or empirically justifiable in the Indian context, and should be reconsidered.

IV. DESIGNING THE REGULATORY OPTION FOR INDIA

The objective of regulation in India should be to promote fair outcomes through an efficient process for takeovers. Efficiency should be the means to achieving the goal of fairness and must be given primacy, except when an efficient outcome is unfair. The aim of this chapter is to suggest a possible path to ensure fairness for all stakeholders through the framework of efficiency, and also to consider in what circumstances must efficiency be deviated from, in order to preserve fairness. Finally, we will propose a framework for a new regulatory regime in India.

A. The path to fairness

As discussed thus far, takeovers result in, for the most part, positive and fair outcomes for the key stakeholders who are affected by it – the buyer, the seller and the minority shareholders of the target. We postulate that the role of the regulation, in this landscape, is to ensure that takeovers are not unduly hindered through onerous regulation. This is the path to achieving the fairest outcome for all stakeholders.

Efficiency, we suggest, may be accomplished by minimizing transaction costs and time. At present, all stakeholders incur significant transaction costs before they can realize the gains that result from a takeover. For instance, the buyer and seller incur search and information costs to locate each other, negotiation costs to reach an agreement, and costs and time related to regulatory compliance.[83] The buyer also incurs additional search, negotiation and information costs to secure financing for the tender offer, as well as a cost on account of the mandatory offer. Obviously, each added cost makes the occurrence of the transaction less likely. Consequently, the elimination or minimization of any of them will lead to a more efficient and thereby fairer outcome.

However, if at any point this efficient regulation leads to unfair outcomes for any of the relevant parties – most likely, the minority shareholders – then the regulation must account for and remedy the unfairness, even at the cost of efficiency. Our guiding principle, after all, is fairness, not efficiency; efficiency is merely the means we have determined to be best suited to ensuring fairness. Additionally, the long-term efficiency of the market is anyway, in part,

[83] RH Coase, 'The Nature of the Firm' (1937) 4 Economica 386; R.H. Coase, 'The Problem of Social Cost' (1960) 3 The Journal of Law and Economics 1; Monika Schnitzer, 'Hostile versus Friendly Takeovers' (1996) 63 Economica 37.

dependent on the fair treatment of minority shareholders even when it comes at the cost of other shareholders, since such treatment will incentivise them to participate and stay invested in the market.

B. Proposed regulatory framework

To reiterate, we believe that in the Indian context the interests of all stakeholders are aligned such that the efficient facilitation of takeovers is the most desirable way to achieve fair outcomes for all of them, and that this efficient facilitation of takeovers can be accomplished by minimizing transaction costs. This principle should guide the approach in framing regulation and should only be set aside when this efficient facilitation leads to patently unfair outcomes.

The removal of the mandatory bid rule – a removal that we have shown is reasonable since minority shareholders neither need nor particularly want it – will significantly diminish a variety of transaction costs, and therefore lead to greater efficiency. The reduction in acquisition price through the removal of the mandatory bid will improve the return-on-investment post takeover and enhance the possibility of securing the required financing. Improved return on investment, in turn, should reduce the likelihood of perverse incentives like short-termism or extraction at the cost of the company's growth, which would be against the interests of the minority shareholders. Additionally, the reduction in acquisition price will make the acquisition viable for a larger set of buyers. Consequently, each seller will be better positioned to find a deal with more acquirer-target synergy, thereby aiding the company's growth and the interests of the minority shareholders.

The removal of the mandatory bid rule, thus, is a clear step towards efficiency and fairness; it increases the overall probability of takeovers going through while simultaneously making "good takeovers", takeovers that are likely to lead to a company's success, likelier. The MBR should therefore not be adopted as the default response mechanism in control transactions, and its removal will lead to generally better outcomes for the buyer, the seller and minority shareholders. This will, in the long term, be favourable for the overall market for corporate control.

With that said, there may nonetheless be specific cases where the removal of the MBR leads to unfair outcomes for any given stakeholder, likeliest minority shareholders. We must seek out such instances and guard against them. Regulatory friction for its own sake must be avoided, but equally, functional friction must be appropriately considered. Set out below are a few illustrative examples.

For instance, in takeovers involving a supernormal control premium,[84] the absence of the MBR allows the seller to extract value at the cost of the minority shareholders, since minority shareholders can neither participate in the sale, nor realize such a high price for their shareholdings on the open market. Fairness requires that the premium be shared by all shareholders. To ensure fairness, therefore, an exception to the default rule of no mandatory offer must be made, an exception that necessitates a mandatory complete-offer rule in such circumstances. Admittedly, an offer size of 100% is a significant enough cost for the buyer to render affected transactions prohibitively expensive. While a few may still go through unchanged, others may not go through at all or go through at a lower purchase price. We are nonetheless compelled to propose this deviation from efficiency because there is no other way to preserve fairness. Having recognized that the only fair outcome where a significant premium is being paid, is to allow all shareholders to share in that premium, to then allow only a few of them to share in those gains (as would happen with a mandatory partial offer rule) is inherently unfair.[85]

"Buy to kill" transactions also need considered thought in the context of a regulatory framework. It has been argued that a partial offer rule such as the MBR in India can act as a filter and protection against such value destroying acquisitions.[86] It is possible that in instances where the incumbent retains part of its shareholding, it will naturally be aligned towards filtering out such "bad" transactions. Two conditions must be satisfied for this to happen: first, the incumbent must not have sold all of its shareholding prior to the open offer; and second, the open offer must see high subscription rates. This high number of minority shareholders tendering their shares reduces the number of shares the incumbent can sell in the open offer due to the *pro rata* purchase rule and, therefore, forces the incumbent to retain target shares. The likelihood of the incumbent having skin in the game in this manner incentivizes it to seek out information about the target's future under various potential acquirers to filter and choose the most efficient one. Theoretically, it can be argued that the MBR should be retained for performing this filtration function. However, we argue that such filtration of bad transactions is both theoretical (since it relies on the incumbent exercising sound judgment) and works only in the narrow circumstance of partial sales by incumbents.

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[84] We choose to not comment on what constitutes a supernormal control premium, instead leaving that determination to the regulator. Our only suggestion here is that any definition adopted must be in the form of a bright-line standard, so as to ensure clarity for all stakeholders.

[85] In case of full subscription, the complete offer rule may under present law lead to a de-listing of the target and concomitant complications. This is not an insurmountable problem, and any legislative change can account for it.

[86] Yueh-Ping Yang & Pin-Hsien Lee, 'Is Moderation the Highest Virtue: A Comparative Study of a Middle Way of Control Transaction Regimes', (2016-2017) 41 Delaware Journal of Corporate Law 393, 437.

Thus, in our paradigm, with the MBR eliminated, this situation of not having an effective filtration mechanism against such "buy to kill" acquisitions will not change drastically in either direction. In any case, a filtration mechanism reliant on the partial sale of the incumbent's shares is an ad-hoc, mar- ket-reliant solution to the problem. The appropriate course of action would instead be to strengthen company law in order to provide greater protection to shareholders and place more onerous duties on and provide greater powers to the board of directors to be able to deal with such acquisitions.

While each of the proposed changes appears to us to be in the interest of all stakeholders, we recognize that some may find it hard to accept any change to a frame work that has been ostensibly designed to protect minority shareholders. Some promoters might feel comfortable with the regime as it exists and may feel vulnerable without an MBR. This is especially true for widely-held companies – with increasing breadth and depth in markets, these companies become relatively vulnerable to hostile takeovers, especially during times of extreme price corrections. To remove the regulatory friction that comes with the MBR today, is to only increase their vulnerability, and therefore their resistance to change. To account for this anxiety, secure stakeholder buy-in,[87] and allow the market time to adapt, we propose that all companies that wish to do so be allowed to opt to have a mandatory bid rule for a limited transitory period. Such a rule would have the same threshold and offer size requirements as the *status quo* partial offer rule, since these requirements are ones which the market actors and regulating institutions are familiar and comfortable with.

This proposal– to do away with the MBR as a default rule but allow shareholders to opt into it – builds upon an idea already existent in the Code, the idea that an acquirer may be exempted from making an offer where the acquisition has been structured through the mechanism of a scheme of arrangement,[88] since schemes of arrangement require the target to obtain the consent of a significant majority of shareholders. The underlying rationale is clear – minority shareholders should be allowed to determine whether they prioritize the ostensible protection of an MBR enough to outweigh its concomitant costs.

[87] "It must be considered that there is nothing more difficult to carry out, nor more doubtful of success, nor more dangerous to handle, than to initiate a new order of things. For the reformer has enemies in all those who profit by the old order, and only lukewarm defenders in all those who would profit from the new order. This lukewarmness arises partly from the fear of their adversaries, who have the laws in their favour; and partly from the incredulity of mankind, who do not truly believe in anything new until they have the experience of it. Thus, it arises that on every opportunity for attacking the reformer, his opponents do so with the zeal of partisans, the others only defend him half-heartedly, so that between them he runs a great danger." – Niccolo Machiavelli, *The Prince* (first published 1532, Fingerprint! Publishing 2015).

[88] Section 10 of the Takeover Code says that if a substantial acquisition of shares or control is made by the means of a scheme of arrangement (Section 230, Companies Act, 2013), and that scheme is assented to by a special resolution backed by a majority of minority shareholders, the requirement that the acquirer make a mandatory public offer stands waived. Admittedly, the scheme is subject to judicial oversight.

However, drawing from a combination of shareholder subscription data and target performance data, we have demonstrated that in the overwhelming majority of cases the better choice is to not have an MBR. Consequently, we are proposing to move to a model where the MBR must be opted in to rather than opted out of, so as to ensure that the only companies that are governed by a less efficient regime are those that have actively chosen to be bound by it.

While our proposed model is *sui generis*, it has intellectual forebears in the form of regulations that allow companies to opt-in to a different model than the default mandatory bid rule in Italy and Switzerland. Recognizing their special place in the economy, Italy does this for Small and Medium Enterprises (SMEs), which may choose to shift the threshold for triggering an open offer-from the default 25% to as high as 40%.[89] Switzerland, on the other hand, not only allows companies to shift the open offer threshold from 33% to 49% by incorporating a clause to that effect in their articles of association,[90] it also allows companies to use similar means to opt out of an MBR requirement entirely.[91] If a company wishes to opt out, transparency provisions and a majority of minority requirement becomes applicable.[92] Further, academic writing has suggested amending the EU regulation to allow opt-ins at the individual company level, instead of at the member state level (like Switzerland and Italy above). It argues that such an "unbiased" approach to takeover law is likely to reduce the incumbent bias of member states, make the rules less susceptible to managerial lobbying, and promote efficient choices at the individual company level.[93]

Taking some cues from the principles underlying these models and applying them to suit our environment, we suggest that a company that wishes to opt-in must do so by incorporating a provision to that effect in its articles of association. This has the benefit of ensuring clarity – since all company's articles of association are in the public domain, a buyer can effectively determine the possible cost of acquiring a given target. We also propose that while enacting or amending the Articles would ordinarily require only a special resolution, to account for the fact that the MBR is meant to represent minority interests specifically, any resolution being passed to opt-in to the MBR regime must have the majority consent of the minority shareholders.

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[89] Federico Picco and others., 'Tender Offers and Takeover Bids in Italy from 2007 to 2019. Empirical Evidence and Discussion Points' (2021) CONSOB Discussion Papers No 9 <https://ssrn.com/abstract=3899754> accessed 23 July 2022; Nicola Asti and Luigi Verga, 'Public mergers and acquisitions in Italy: Overview' (*Thomson Reuters Practical Law*, 1 November 2021) <https://uk.practicallaw.thomsonreuters.com/9-502-1314?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a109593> accessed 23 July 2022.

[90] Financial Market Infrastructures Act 2014, art 132.

[91] *Ibid* art 122(4).

[92] *Ibid* art 122(5).

[93] Luca Enriques, Ronald J Gilson & Alessio M Pacces, 'The Case for an Unbiased Takeover Law (with an Application to the European Union)', (2014) 4 Harvard Business Law Review 85, 121.

Admittedly, the ability to opt-in does mean that some companies will do so even when they do not need to, due to status quo bias. This automatically allows for the regulator to have two kinds of companies to oversee – those functioning with and those functioning without the mandatory bid rule, thereby facilitating an analysis of shareholder response in both cases. At the end of the transitory period, the regulator will hopefully have enough information to take a considered view on what worked and what did not, thereby facilitating the creation of more robust standards, which will result in even greater efficiency in the market.

To summarize, then, the proposed regulatory framework is one where there exists no mandatory offer rule of any kind. Exceptions must be made, however, whenever the removal of the mandatory offer rule leads to unfair outcomes. The example we take to illustrate this point is that of takeovers with supernormal control premiums being paid, where we say a mandatory complete offer rule must be incorporated to ensure fairness. In addition to this, to allay the fears of companies that become more vulnerable to hostile takeovers as well as to secure market buy-in, all companies may choose to opt-in to a mandatory partial-offer regime for a transitory period. This will have the additional advantage of creating a regulatory sandbox of sorts, allowing the regulator to make an informed choice with more data available.

V. CONCLUSION

The regulator in India has correctly emphasized, in every report, that an important aim of takeover regulation must be to promote fairness in control transactions. All this while, it has assumed that this fairness can only be achieved by allowing shareholders an exit at the time of takeovers. This assumption has largely remained unexamined – we have sought to examine it, challenge it, and determine that it is unfounded.

Takeover regulation in India is steeped in borrowing from other jurisdictions. This borrowing happened especially from jurisdictions comprised dominantly of diversely held companies. Consequently, it is only natural that our own takeover regulation is perhaps better suited to protect the interests of minority shareholders in that context, than in our own. Our market is comprised mostly of concentrated-ownership companies, and most takeovers are friendly. This requires a different regulatory approach. As we have demonstrated, the MBR, which often precludes these friendly transactions from happening, is in fact detrimental not only to the interests of the buyer and the seller but also to the interests of minority shareholders.

It is also not a particularly useful tool for enabling exit, specifically when a takeover is going to have an adverse effect, since shareholders are unable to predict when takeovers will affect companies adversely. All it does, then, is

make good takeovers - takeovers that are going to increase the value of the target – less likely to happen and more inefficient when they do happen. This is a bad outcome for all stakeholders. Nor is it a tool that minority shareholders particularly want, as the subscription data reveals.

Consequently, our key takeaway is that the MBR as it exists does not serve a useful purpose in the context of takeover regulation in India. The fairest and best outcomes for all stakeholders are most likely to be arrived at in the absence of regulatory friction as a general rule.[94] However, there exist situations where regulatory friction serves a function, where not having some friction will create unfair outcomes, and such circumstances must be accounted for in any regulatory framework or through changes to company law.

The move away from the MBR, then, must be seen not as a move away from fairness, but rather as a move that better reflects what constitutes fair outcomes for all stakeholders.

[94] That we are nonetheless allowing companies to opt-in to a mandatory partial-offer regime is not a concession to its situational superiority but rather an attempt to allay the fears of vulnerable stakeholders and secure market buy-ins by allowing a transitory period.