M&A Interactive

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MEGA M&A DEALS: CONSPICUOUS BY THEIR ABSENCE IN INDIA!

2015 has already seen a record number of "mega M&A deals"[1] globally including the recent mega takeovers of SABMiller and EMC Corp by AB InBev and Dell respectively.[2] However, by all counts and even by Indian deal market standards mega M&A deals have been absent historically and more particularly this year in India.[3] As per the report published by the Securities Exchange Board of India (SEBI), the largest open offer this year thus far was valued at around INR 132 crores (USD 20 million).[4] While, the level of anti-trust scrutiny is never a conclusive parameter to deduce whether mega deals are present in a given market, nevertheless they provide some indication on the nature of the M&A market. In India since the inception of the merger control framework[5], out of the 264 cases reported to the Competition Commission of India (CCI) only 2 cases have undergone a detailed scrutiny (also referred to as Phase II investigations) which at the very least indicates the absence of large strategic deals in India. In this interactive, we try and explore the possible cause(s) that is plaguing the mega M&A deal market in the context of India.

I. FACTORS THAT FACILITATE A MEGA DEAL MARKET

While it is difficult identify the factors that facilitate mega deals with any degree of certainty, existing literature in the field indicates that (a) a robust macro-economic outlook in the medium to long term, (b) upward stock market movement, (c) level of competition in a market/industry and (d) availability of credit (both on the corporate balance sheet and other external sources of funding) are the some of the key factors that form the bedrock for the creation of a mega deal market.

II. IS A MARKET FOR MEGA DEALS NECESSARY?

This interactive is not an endeavor to argue that "mega" or "large" M&As are necessarily good for the economy or any of the stakeholders. In fact there is existing literature which suggests that mega M&As destroy value for the acquiring shareholders and that most large M&As fail.[6] Having said that in the larger scheme of things an environment for large M&As may be a "necessary evil" as such M&As typically reflect the corporate morale and consequently provides some form of anecdotal evidence on the macro-economic outlook. Large M&As can also help create strong and stable companies. For example, during the 2008 global financial crisis the US Government actively brokered deals in the larger interest of the economy and the financial system.[7]

The limited point is that whilst we have no empirical evidence to suggest that mega deals are beneficial for a target country (and the same is outside the scope of this interactive), there should be no reason for the law makers in a free economy to not provide companies various restructuring options including the ability to undertake large strategic M&As, leverage buyouts, take private transactions etc.

III. WHAT IS PRECLUDING MEGA DEALS IN INDIA?

The medium to long term macro-economic outlook for India has remained mostly promising and after the general elections last year, the outlook has only improved exponentially. However, the euphoria on the macro-economic front has not resulted in any high value deals especially this year. Intuitively this raises several questions- Is the macro-economic environment as good as it is made out to be? Are Indian companies in a growth phase as opposed to a consolidation phase? Are there other factors that are impeding large deals?

While there is no denying the fact that most Indian companies are in the growth phase as opposed to a consolidation phase, there is no reason to believe that the two cannot co-exist. For e.g. there are several industries were large strategic M&A are desperately required such as telecom. Similarly, there are several public companies that could (and are required to) be restructured, delisted, strengthened and listed again through a typical leverage buyout transaction.

It is extremely difficult to empirically prove the factors that are precluding such large deals in India especially given the presence of large buyout firms. However, it appears that (a) large block of promoter holdings in Indian companies, (b) non-availability of cheap and external credit and (c) other regulatory factors are impeding the growth of a robust M&A market. It is difficult to imagine that large promoter holdings are alone precluding large deals as promoter holdings in Indian companies has been declining over the years and now there are several "blue chip" companies that have dispersed shareholding with no identifiable promoter. Therefore, by deduction it appears that regulatory factors and availability of external credit could be impeding the growth of the M&A market in India.

While, several structures (both onshore and offshore) have been used including asset acquisition for deal financing, it is no secret that external sources of financing for M&A deals (especially acquisition of shares of a public listed companies which are typically the target for large M&As) are extremely difficult if not impossible because of regulatory policies or the sluggish implementation of the existing policies.[8] Indian companies have raised capital from the equity markets through qualified institutional placements (QIPs) or private placements to fund M&As. Globally equity financing is not typically used for funding large M&As as it proves to be expensive. Indian corporates

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have also tried to tap the global capital markets for meeting their investment needs but because of end-use restrictions on the use of such capital for M&As, this avenue also does not provide the necessary source of currency for funding large M&As. These avenues are likely to freeze further given the imminent tightening of the global credit markets.

The major disappointment, however, has been the availability of debt financing. The bond market especially "junk bonds" which has been a major source of M&A financing globally is at a very nascent stage in India[9] and therefore has not been able to provide the funding support for large M&As. Further, while the bond market has grown over the years, the demand has been more for investment grade bonds as opposed to "junk bonds". In the absence of a robust bond market one has to rely on bank financing. The prudential norms prescribed by the Reserve Bank of India (RBI) does now permit banks to finance acquisition of shares and therefore this source of financing is also not available in India.

Apart from the credit environment, the foreign investment norms on creation of security in favour of a non-resident or pledge of securities by non-residents makes it extremely difficult for traditional buyout firms to finance a large M&A deal in India. Additionally, the new Companies Act, 2013 does not allow a public company to provide security for the acquisition of its own shares and consequently restricts the ability to undertake a typical leverage buyout.[10]

It is imperative that some of the regulatory barriers are removed to create a robust M&A market and provide both foreign and domestic firms wider ammunition to restructure their businesses and fully realize the inorganic growth potentials. Both the RBI and SEBI realize this and therefore have taken some small steps in this direction. RBI recently permitted leveraged buyout of "stressed companies".[11] SEBI, on its part has relaxed the norms for delisting of listed companies and consequently created an enabling environment for "take private transactions".[12] While small steps are being taken to create an enabling environment for M&As and other types of restructuring opportunities, a more concerted effort from the Government and all concerned regulators such as RBI, SEBI, CCI etc. is necessary to achieve a more robust M&A market in India.

– Ankit Mishra & Simone Reis
You can direct your queries or comments to the authors

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[1] There is no formal definition of what constitutes a 'mega deal'. However, typically a deal for a purchase consideration of USD 1 billion or more is considered as a 'large'/'mega' deal. Having said that, the definition could differ from one jurisdiction to another depending on the market capitalization of the companies in such jurisdictions.

[2] James Fontanella-Khan and Arash Massoudi, "Megadeals for 2015 hit record high", New York and London, September 18, 2015, available at http://www.ft.com/cms/s/0/9ef27ce8-5d65-11e5-9846-de406ccb37f2.html#axzz3oXAVQhQW (last visited October 14, 2015). This article evaluates the inbound M&As and not outbound M&As involving Indian companies as outbound M&As are governed are typically governed by the laws of the host/targets jurisdiction and are mostly driven by non-domestic factors.

[3] Kanika Datta, "M&As: Waiting for the Bing Bang", New Delhi, October 7, 2015, available at http://www.business-standard.com/article/companies/m-as-waiting-for-the-big-bang-115100701367_1.html (last visited October 14, 2015).

[4] Details of Open Offers made under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 and SEBI (Substantial Acquisition of Shares and Takeovers), Regulations, 2011, available at http://www.sebi.gov.in/cms/sebi_data/takeover/takeoverapr2015.html (last visited October 14, 2015). Under the Indian takeover laws, the minimum mandatory open offer size has to be a minimum of 26% of the voting capital of the company and the offer price cannot be lower than the negotiated price for the principal transaction that triggers the open offer, therefore the size of the offer is typically a good indicator to deduce the value of the deals.

[5] S. 5 and S. 6 of the Competition Act, 2002 which are the principal provisions relating to the notification of M&As was brought into force on March 4, 2011.

[6] "Mergers: Why Most Big Deals Don't Pay Off", *BusinessWeek*, 14 October 2002; "A Brave New World of M&A: How to Create Value from Mergers and Acquisitions", *The Boston Consulting Group*, July 2007; G. Alexandridis, K.P. Fuller, L.Terhaar and N.G. Travlos, "Deal Size, Acquisition Premia and Shareholder Gains", January, 2011, available at www.efmaefm.org/0EFMAMEETINGS/.../2011-Braga/.../0252.pdf (last visited October 15, 2015).

[7] Timothy F. Geithner, "Stress Test: Reflections on the Financial Crisis", May 12, 2014; Andrew Ross Sorkin, "Too Big To Fail", October 20, 2009.

[8] Narendra Chokshi, "Challenges Faced in Executing Leveraged Buyouts in India", April 2, 2007, available at https://www.stern.nyu.edu/sites/default/files/assets/.../uat_024317.pdf.

[9] Sunder Raghavan, Ashok Sahoo, Angshuman Hait and Saurabh Ghosh, "A Study of Corporate Bond Market in India: Theoretical and Policy Implications", March 4, 2014 available at https://rbi.org.in/scripts/PublicationsView.aspx?id=15725.

[10] S. 77 (2) of the Companies Act, 2013

[11] Since some of the restrictions on implementing a leverage buyout are beyond the regulatory domain of the RBI, the classic leveraged buyout is still a challenge. However, this has to been as a dilution on the prudential restrictions on banks to finance share acquisitions.
12 NDA Hotline, "Going Private Transactions: Set For A Boost", available at http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/going-private-transactions-set-for-a-boost.html?no_cache=1&cHash=a3c3f46d01a1cdcc5ffe9af67697528b

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