HOSTILE TAKEOVER: CASE STUDY OF RAASI CEMENTS LIMITED TAKEOVER BY INDIA CEMENTS LIMITED

*** SANDEEP KUMAR MOHANTY [1]**

I. INTRODUCTION

A takeover takes place when one company acquires control of another company, usually a smaller company than the first company. It may be defined as a transaction or series of transactions whereby a person (individual, group of individuals or a company) acquires control over the assets of another company, either directly by becoming the owner of those assets or indirectly by obtaining the control of the management of the company. [2] The company, which acquires control of another company, is called the '**acquirer'** or offeror whereas the company, which is acquired, is called the '**target'** or offeree. In a case where shares are closely held (i.e. held by a small number of persons) a takeover will generally be effected by agreement with the holders of the majority of the share capital of the company being acquired.

A takeover bid is a technique for effecting a takeover or a merger : in the case of a takeover, the bid is frequently against the wishes of the management of the target company; in the case of a merger, the bid is generally by consent of the management of both companies. It may be defined as an offer to acquire shares of a company whose shares are not closely held (dispersed shareholding), addressed to the general body of shareholders with a view to obtaining at least sufficient shares to give the offeror voting control of the company. [3] The distinction between a 'takeover' and a 'merger' is that in a takeover the direct/indirect control over the assets of the acquired company passes to the acquirer, in a merger the shareholding in the combined company will be spread between the shareholders of the two companies. Often the distinction is a question of degree. [4]

[1] Advocate, Odisha ; email:- mohanty.sandeep27@gmail.com
[2] Weinberg and Blank on Takeovers and Mergers (London: Sweet and Maxwell, 1999) vol. 1 at 1005.
[3] Supra note 1,at 1006
[4] In **Re: Bihari Mills Ltd. V. Unknown**; 1985 58 CompCas 6 Guj

II. WHAT IS HOSTILE TAKEOVER?

A takeover bid may be undertaken in the form of an offer to purchase shares for cash or of a share-for-share exchange or of a combination of those two forms. In other words, the consideration part in a takeover bid may be cash, or shares/debentures of the acquiring company, or the shares of a third company, which has nothing to do with the takeover.[5] The Bhagwati Committee on takeover has recommended that the acquirer should be permitted to offer shares of the third company as consideration for shares tendered. This is essentially to increase the flexibility available to the acquirer in funding the offer. However, in a merger, it always takes the form of a share-for-share exchange offer, so that the accepting shareholders in the offeree company become shareholders in the offeror company.[6]

A takeover may broadly be classified into two categories: [7]

a) **Friendly Takeover**:

Where the Board of Directors of the target agree to the takeover, accept the offer in respect of their own shareholdings and recommend other shareholders to accept the offer. The directors of the target may agree to do so right from the start after early negotiations or even after public opposition to the bid (which may or may not have resulted in an improvement in the terms of the proposed offer); or the directors of the target may *actually have approached the offeror to suggest the acquisition. In a friendly takeover,* the controlling group sells its controlling shares to another group of its own accord. Because of Regulation 12 read with Regulation 3(1)(c) of the SEBI Takeover Regulations, 1997 there is no compulsion to make an open offer in a friendly takeover.[8]

b) **Hostile Takeover:**

A takeover bid is hostile if the bid is initially rejected by the target Board. It is sometimes also called 'unsolicited or unwelcome bid' because it is offered by the acquirer without any solicitation or approach by the target company. In a hostile takeover the directors of the

[5] Corporate law review research paper on : Legal regulations of hostility.
http://www.lawteacher.net/free-law-essays/business-law/corporate-law-review-research-paper-law-essays.php#ixzz44Uh4QP8Y
[6] Sanjeev Sharma and Vivek Sinha, "Bhagwati Panel Draft Proposes Bank, FI Funding of Takeovers", The Economic Times, April 9 2002, p.1.
[7] Supra note 1,at 1006
[8] http://www.sebi.gov.in/commreport/mfrep1

target company decide to oppose the acquiring company's offer, recommend shareholders to reject the offer and take further defensive measures to thwart the bid.[9]

There may be different motives/causes behind launching a takeover bid and it is not necessary, that only poorly performing firms are the potential targets of a hostile bid. Bidders seem to pursue companies with strong operating managements as often as they pursue companies that have been clearly mismanaged.[10] In fact bidders seldom seem to be interested in a firm where a turnaround is unlikely. For instance, truly sick companies – or at least those whose problems do not appear to be easily remedied – become indigestible and survive, immune from takeover, precisely because of their inefficiency. A bidders offers a premium, often very high, to acquire a target and a rational bidder will offer such a premium over the market price (and incur notoriously high transaction costs as well) only if it believes that the future value of the target's stock under different management will exceed the price it offered the target's shareholders within a relatively brief period.[11] There may be a number of objectives behind mounting a hostile bid. It may be a strategic objective like consolidation/expansion of the raider/acquirer. It may be aimed at achieving 'economies of scale'/critical mass/reducing costs in a particular product/service market. It may also be aimed at acquiring substantial market share or creating a sort of a monopoly.[12]

Takeovers perform following important functions in an economy:[13]

- Successful takeovers help realise efficiencies by reallocating capital and corporate assets to more high-value uses; enabling two entities to generate joint operating efficiencies and providing companies access to financial, management and other resources not otherwise available.
- It unlocks the hidden value of unutilized or underutilised assets by transferring them from inefficient management to an efficient management. This function of takeovers is commonly described as the 'market for corporate control'.[14]

[9] http://www.encyclopedia.com/topic/Acquisitions_and_mergers.aspx
[10] *Infra* note 21, at 1207.
[11] Hostile Takeovers : Emerging; Trendshttp://shodhganga.inflibnet.ac.in/bitstream/10603/7210/13/13_chapter%206, last viewed on 31.03.2016
[12] http://www.investopedia.com/terms/e/economiesofscale.asp
[13] Krishnan Thiagarajan, "Fending off Hostile Raiders – Whining Corporates may Stifle the Takeover Market", *The Business Line*, Nov. 26 2000, p.6.

According to Weinberg and Blank a takeover may be achieved in the following ways:[15]

- Acquisition of shares or undertaking of one company by another for cash.
- Acquisition of shares or undertaking of one company by another in exchange of shares or other securities in the acquired company.
- Acquisition of shares or undertaking of one company by a new company in exchange for its shares or other securities
- By acquisition of minority held shares of a subsidiary by the parent.
- Management buyouts.

III. CASE STUDY OF RAASI CEMENTS LIMITED TAKEOVER BY INDIA CEMENTS LIMITED

Though the India Cements Limited (herein after referred to as "ICL") acquired the Hyderabad-based Raasi Cements Ltd. (herein after referred to as "RCL") in a negotiated deal for Rs. 140 crores, the deal could be reached only after three months long "hostile takeover" bid mounted by the ICL over RCL. Dr B V Raju, the chief promoter agreed to sell his entire 32 per cent holding in RCL at Rs. 286 per share.

A careful study of the events that took place before the deal was reached gives an insight into the issues involved in a hostile takeover deal. In order to thwart the hostile takeover, Mr. Raju had challenged the SEBI's takeover code in the Andhra Pradesh High Court arguing that the takeover code does not give the promoters any chance to defend it. However, after an initial stay, the Andhra Pradesh High Court vacated its earlier stay against the takeover proceedings. [16]

When looked at the takeover bid from target shareholder's point of view, between October 1997 to March 1998, the RCL stock rose by a whooping 318 per cent. In contrast, during the same period the ICL stock fell by 46.36 per cent. On the other hand when the sale was agreed upon, the Raasi scrip crashed to Rs 181 from Rs 187 at the closing on the BSE while India Cements' share improved to Rs 63.15 from Rs 57.60.

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[14] Manne's theory as 'Disciplinary Hypothesis'. Cf. Lyman Johnson and David Millon, "Misreading The Williams Act", 87 *Mich. L. Rev.* 1862, 1878 (1989).
[15] *Supra* note 1, at 2009.
[16] http://legalsutra.com/545/hostile-takeovers/

The movement in RCL scrip can be explained by the fact that the shareholders of RCL expected a high premium on their shares if the hostile bid turned out to be successful but when it ended in a negotiated deal the share prices fell because shareholders lost the opportunity to make some quick bucks. Though generally, the share price of the target company should remain high even if the initial bid has failed on the expectation of a fresh tender offer from other bidders. But when the bid has ended in a negotiated deal, there is no possibility of a fresh offer and expectation of a high premium is naturally dashed pulling the share price down. [17]

However, what explains the downward movement in the share price of ICL when the hostile bid was on and subsequent rise in its prices when the target was acquired in a negotiated deal? How and in what manner would the acquiring company's shareholders (ICL in this case) benefit? This is a function of the synergies in production; marketing and distribution expected from the takeover and the future growth strategies of the acquirer. The possibilities of sales enhancement, greater market share, operating economies and improved management would all decide the rewards to the acquiring company's shareholders in the future. [18] The initial downtrend in the ICL stock can probably be explained due to some apprehension in the market that the ICL may be willing to pay too high a premium, which may not be offset by the gains that may accrue due to synergy of operations and management between the two companies. Now it is worthwhile to investigate into the possible reasons that may have triggered the hostile bid by ICL against RCL.[19]

a) Dolorous Stock Prices

Due to general economic recession prevailing in the last 2-3 years, the demand for cement has been very sluggish. This has resulted in bringing down the P/E ratios of several cement scrips to just 6 or 7. At these abysmally low prices, several cement companies with capacities of around one million tonne can be acquired for Rs. 150-200 crore.[20] Hence predators find it more reasonable and attractive to launch a takeover bid rather than going in for expansion. For example, setting up a 1 million tonne plant would roughly cost around Rs.400 crores. RCL

[17] http://people.stern.nyu.edu/adamodar/pdfiles/papers/acquisitions
[18] http://www.investopedia.com/ask/answers/031815/what-strategies-do-companies-employ-increase-market-share.asp
[19] http://www.referenceforbusiness.com/encyclopedia/Man-Mix/Mergers-and-Acquisitions.html
[20] *Source: India Infoline.* Cf. Anirudha Dutta, "After Bombay Dyeing Who's Next?" <www.indiainfoline.com/pobl/13oct00.html>

has a capacity of 1.6 million tonnes[21] and setting up a new plant of same capacity at current prices would entail an outgo of around Rs.550-600 crores. Therefore, it is clear that the market capitalization of most cement stocks was way below the cost of setting up similar capacities. By comparing the market capitalization of both RCL and ICL before and after the takeover announcements it is found that the market capitalization of ICL prior to the takeover announcement in October 1997 was Rs. 603.17 cores, which came down to Rs.371.55 crores in March 1998. In contrast, the market capitalization of RCL before the hints of takeover in October 1997 was just Rs.94.62 crores. The subsequent developments on the takeover front helped in bringing this upwards to Rs.230.18 crores in March 1998. The shareholders of no other cement company had such a windfall in terms of value gained considering that bottomlines of most players in the cement industry had been badly hit.[22]

b) Expedite Revenue Generation

ICL probably also realized that takeover would help in augmenting revenues. Given that in the normal circumstances the gestation period of a new plant is usually 30 months before revenues trickle in, the acquisition route would streamline this gap. In a takeover, the entire process would take around 6 to 8 months before the process is completed and revenues are generated. [23]

c) Alluring capacity

Companies in the cement industry have been aiming at garnering large capacities to remain competitive and ensure future survival and growth. ICL's acquisition of RCL also reveals this trend. The cement industry in the country is in a fragmented state with 59 companies operating with 115 plants. Nine groups make up for 65 per cent of the total capacity – a clear indicator that the consolidation is due.[24] ICL had started adding capacities through acquisitions much before the acquisition of RCL. In 1997-98 alone, ICL had added 2.2 million tones (mt) of fresh capacity through acquisitions and expansions. Its capacity has increased from 1.4 mt in 1989 to 4 mt by early 1998. ICL took over Visakha Cements (0.9 mt) for Rs 380 crore and the public sector Yerraguntla plant (0.4 mt) for Rs.198 crore both in AP. This coincided with the going on stream

[21] In 1997, Gujarat Ambuja had acquired Modi Cement with an installed capacity of 1.5 million tonne for just Rs.166 crore.
[22] All the figures mentioned herein have been taken from Prabhavathi Rao, "Hostile Takeovers-Sharks on the prowl", *Analyst*, May 1998, Cf. <www. icfaipress.org/archives/Analyst/1998/may/cover-Hostile Takeovers Sharks on the prawl.htm>
[23] Mergers and Acquisitions of Companies By P.M. Rao
[24] In 1999, the French cement major Lafarge acquired Raymond Cements.

of ICL's Greenfield plant (0.9 mt) at Adalvoi in Tamil Nadu. RCL has come in as a golden mine for ICL - by dint of acquiring RCL's 2 mt plant, ICL has emerged as the second largest cement maker in the country after ACC (10 mt capacity), tucked with a capacity of 7.5 mt and an enviable 35 per cent market share in South India - to achieve growth. Thus, comfortably for ICL, the acquisition of RCL has led to enhancing capacity without creating new ones.

d) Mushrooming market share

ICL could now cash in on its dominant position, especially in the southern market and pursue an aggressive pricing strategy. With the takeover of RCL, ICL would be able to enjoy the benefit of having all its plants in one region, thereby ensuring a substantial market share in the region. Post acquisition, ICL's market share is expected to be 30.77 per cent in Tamil Nadu, 34 per cent in Kerala, 30 per cent in Karnataka and 43 per cent in AP, raising its aggregate market share in the South to 33 per cent from the earlier level of 14 per cent. It would be now easier for ICL to enter the cement deficit regions of Tamil Nadu and Kerala and in consolidating its position in the southern markets. Another interesting factor in ICL's favour is the higher growth in demand for cement in the south as compared to the national average.[25] Prices in the Southern markets are generally known for being steady in comparison to that in the North. Competition has gathered momentum in the Southern market of late what with L&T's 1.75 mt plant's operations on the anvil in Andhra Pradesh, Madras Cements' expansion plans and Gujarat Ambuja's aggressive strategies of late. ICL's moves seem to be in the right direction.[26]

e) Cost Aggressiveness of RCL

RCL's perhaps most important attraction is its cost effectiveness in comparison to ICL. A look at the statistics reveals as to how RCL is highly cost competitive. For instance, its raw material costs per ton is lower than ICL by nearly 42.16 per cent, power and fuel costs are lower by 24 per cent, and employee cost is a merely a fraction (28.2 percent) of ICL. RCL's only achilles' heel seems to be its higher selling and distribution costs - 20 per cent higher than ICL. This could be attributed to its wide distribution network in several states. In comparison, ICL's sales primarily come from Tamil Nadu and Kerala. ICL can also hope to save on logistics per annum

[25] http://www.business-standard.com/article/specials/solid-foundation-198042001062_1.html
[26] http://epaper.timesofindia.com/Repository/ETM/2009/07/23/ETM_2009_7_23

post acquisition scenario to the tune of nearly Rs.20 crore.[27] Additionally, the rationalization of various markets between ICL and RCL and by cashing in on ICL's distribution network, the new ICL should be able to realize around Rs.200 per tonne. The benefits of economies of scale, the synergies of the juxtaposed operations would help ICL in realizing stronger cash flows. This should happen thanks to ICL gaining a greater regional foothold and market leadership.[28]

IV. BOON TO THE SHAREHOLDERS

It is important to note what the shareholders should actually do during such bid offers. Given that the offer generally would be accepted for a small portion, mandatory bid is to offer for 20% of the equity, it would be sensible to offload the shares in the market when the prices are ruling high on the back of takeover news, even though it may be at a discount to the offer price because once bid is accepted share prices will revert back to the normal pre-bid level. Consider the case of RCL.[29] The market price of the scrip at the time of the bid was around Rs.200, in comparison to the offer price of Rs.300. It would not be easy for every shareholder to realize this price. Accepting a certainty of Rs 200 could be more practically appealing to some shareholders as against the uncertain Rs. 300. Balakrishnan, a shareholder evinces interest in such a situation. He explains, "If I submit my shares under the offer and if only part is accepted, the certificate for the balance will come back to me after three months or so. By this time, the market price will fall back to earlier levels of under Rs 100.[30] This is a risk to be evaluated carefully. SEBI can help in this regard by making it compulsory to accept all offerings up to a maximum of say 500 shares per applicant. This will offer relief to small shareholders. For the institutions they can do a negotiated deal outside the offer, with either the existing promoter or the raider at a higher price, which is possible given the circumstances."[31] ICL's acquisition of RCL should help in enhancing the shareholder value of ICL shareholders in the long run. This is because the market-share of ICL moves up after the acquisition with the company emerging as the largest cement producer in South India. And given the current wave of consolidation in the cement industry, the open offer also benefits the shareholders of RCL thanks to the attractive offer price.[32]

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[27] http://ficci.in/spdocument/20217/FICCI-KPMG-Report-13-FRAMES
[28] http://legalsutra.com/545/hostile-takeovers/
[29] http://www.sebi.gov.in/commreport/bagawati-report.html
[30] http://www.indianjournals.com/ijor.aspx?target=ijor:fnwe&volume=17&issue=4&article=011
[31] *Supra* note 82.
[32] http://www.indmin.com/Regulation-LatestNews.html

V. ICL SHAREHOLDERS TO REAP BENEFITS

Now, it is interesting to have a look at the post-acquisition scenario in order to determine as to whether acquisition of RCL has actually benefited, and, if yes, to what extent, ICL shareholders. After acquiring RCL later, in 1999, ICL also acquired Sri Vishnu Cements Ltd. (1mt. Capacity) – another Raju promoted company in which RCL already had 49% holding. Therefore, with the acquisition of RCL and its subsequent merger with ICL, ICL also got a 49 % holding in SVCL. For ICL group, Sri Vishnu cost little over Rs. 170 crores. This meant an average price of Rs. 76 per share, though it paid about Rs. 100 per share to the minority shareholders while complying with the takeover code through an open offer.[33] As can be seen in the Table 2 below Post SVCL acquisition the paid equity capital has shown an increase. Though the acquisition spree launched by ICL catapulted it to the top in terms of capacity, alongside ACC, Grasim Industries and Larsen & Toubro, its profitability came under considerable strain and its acquisitions are yet to pay. The acquisitions largely financed by debt coupled with a recession in the market, the company is nowhere near to get the kind of returns for the price (Rs. 300 per share and close to Rs. 400 crores) paid for Raasi Cements.[34] It had a total debt of close to Rs. 1,800 crores as at the end of March 2001. Earning per share has shown a steady decline from March 1998, and the decline has been around 40% when compared to the figures in 1996-97 and 1997-98. What may have acted as a dampener on company's performance, apart from high financial costs, is the cement price trends. In 1999-2000, despite a 15 per cent growth in volumes, prices were flat with periodic moves in either direction. Though prices improved thereafter the company continued its insipid show, as the company's first quarter results in 2000-1 were not encouraging compared to those in the first quarter of 1999-2000. The operating profit margin declined by 1.4% from 22.8% to 21.4%. Net profit also showed a decline from Rs. 7.4 crores to Rs. 5.7 crores – a decline of almost 30%. The large debt burden in spite of soft interest continued to take a heavy toll on the company's profitability and hence shareholder returns and unable to improve its bottom lines ICL was forced to sell its 39.5% stake in SVCL in Jan. 2002. [35]Therefore, what we see in this case is that a (hostile) takeover almost invariably increases target shareholder value but the same may not be true of returns to the shareholders of the acquirer company. If the

[33] http://www.thehindu.com/2002/01/11/stories/2002011100571600.htm
[34] http://indiatoday.intoday.in/story/indian-pharma-firms-on-acquisition-spree-buyouts-to-expand-product-lines/1/191595.html
[35] Financial Performance of India Cements Ltd. Account of ICL for 1998-99 incorporate results of RCL w.e.f. April 1, 1998.

decision to takeover another company was not taken with prudent economic interests in mind, it may lead to decrease in the wealth of shareholders of the acquiring company.[36]

VI. CONCLUSION

There are certain advantages and disadvantages of a hostile takeover and it may be difficult to categorise it into a strict mould in order to say that hostile takeover should be promoted or discouraged. It is a widely shared belief that hostile takeovers allow the shareholders of the target company realise the best price of their investment or in other words it promotes economic efficiency by transferring the control of corporate resources from an inefficient management to an efficient one. While it is true that hostile takeovers are value-maximising to the target shareholders; some hostile takeovers may promote efficiency, some may result in a misallocation of economic resources, and some may be neutral in terms of economic efficiency. After all market behaves on the basis of past records and future expectations and therefore, when a company makes a bid for another share price of the target generally rises in anticipation of more profits and greater shareholder returns from the company under the new management. But, there is no guarantee that the new management would not mismanage and hence, if mismanaged, the reallocation of resources may not be promoting efficiency. When a well-managed company is acquired by another equally well-managed company, the takeover may be neutral in terms of economic efficiency. Secondly, the proponents of hostile takeover zealously argue that hostile takeover has a disciplining effect on inefficient managements and therefore, an active market for corporate control is not only desirable but it should be promoted. However, this disciplinary hypothesis – namely, that poor stock market performance implies poor management - also has its limitations. Poor stock prices may be due to a number of non-economic reasons and something else may be occurring on an industry-wide basis, or on a narrower basis within a portion of that industry, that precludes an inference of managerial failure based solely on below average stock performance. For example, an overproduction in the world steel market coupled with low demand has caused share prices of steel company to fall steeply, however, it does not imply that TISCO is a poorly managed company and hence a potential takeover target. Further, bidders seem to pursue companies with strong operating managements at least as often as they pursue companies that have been clearly

[36] http://www.referenceforbusiness.com/small/Mail-Op/Mergers-and-Acquisitions.html

mismanaged and a bidder's search will be biased in favour of industries in which it already operates. Since firms within the industry have greater knowledge about each other's properties, products and prospects, this certainty of information enables the bidder to pay a higher premium to emerge as the winning bidder. This may result in the displacement of a competent management of the target after acquisition. In such situations the Disciplinary Effect of hostile takeover has no consequence.

Therefore, it is appropriate to say that the market for corporate control has a disciplinary effect, but the scope of that effect tends to be more limited than neo-classical economic theory has made it out to be.

As a consequence, a public policy toward hostile takeovers that seek to promote them in the interests of economic efficiency and greater shareholder returns may have to contend with the dangers of increased industry consolidation and oligopolistic market.

Now, the question arises whether the conclusion drawn above varies from country to country and can it be something different in case of India?

In the specific Indian context, we have a long history of family run business houses which tend to pay scant regard to improving returns to shareholders and vast economic assets are lying underutilised under their control, it may be desirable to allow a regulated but not restricted market for corporate control to operate in order that old blue-chip companies are run in accordance with sound management principles and the influence of corporate families are reduced on the running and management of the company. What should be guarded against is the notorious US-style 'bust-up' takeovers and the impact of hostile takeovers on non-shareholder constituencies must also be kept in mind.