NSE

Edited Transcript of the Panel Discussion on

Law and the Evolution of Outbound Acquisitions by Indian Firms

Mumbai, May 28, 2012

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National Stock Exchange of India Limited

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Preface

Indian firms have gained significant attention in the world economy over the past decade partly due to their overseas acquisitions. By acquiring companies abroad, they have been able to establish new, international consumer bases and also to boost their share in the world markets. Further, it has given the Indian multinationals access to business resources, such as technology and intellectual property. Many Indian corporates have gained confidence about their capabilities of carrying out businesses abroad and increasingly see it as a way of becoming globally competitive. Hence, outbound acquisitions are a matter of significant importance for the corporate sector and perhaps for the economy as well.

While business motivations are paramount in the drive toward outbound mergers and acquisitions (M&A), the legal environment governing such acquisitions determine their number, structure and relative success. India's economic liberalization in early 1990s and its corresponding regulatory changes, including changes that have led to the increased availability of capital, had set the stage for outbound acquisition. The additional reforms undertaken in the last decade together with the growing aspirations of Indian corporates to go global, led to an acceleration of outbound acquisitions beginning 2005. It is widely expected that this trend would continue. Nevertheless, there still remain some issues which are hindering the Indian firms from fully realising their potential in this respect.

In this context, NSE organized a panel discussion on **"Law and the Evolution of Outbound Acquisitions by Indian Firms"** in May, 2012. The aim of the discussion was not only to highlight the legal environment that have facilitated outbound acquisitions by Indian multinationals, but also to identify the issues that have emerged over the years.

The panellists of the seminar were practitioners, industry experts and academics. A wide spectrum of stakeholders participated in the seminar as audience. The seminar deliberations have been captured in this edited transcript.

We believe the transcript would be useful for industry, academics and policy makers.

Nirmal Mohanty
Vice President
Department of Economic Policy and Research
National Stock Exchange

Executive Summary

As part of its outreach initiatives, the National Stock Exchange (NSE) organized a seminar on **"Law and the Evolution of Outbound Acquisitions by Indian Firms"** on May 28, 2012. The seminar included a presentation and a panel discussion on the subject. The presenter and the panellists were practitioners, industry experts and academics. A wide spectrum of stakeholders participated in the seminar as audience.

A. General Observations

I. Trend of M&A deals by Indian firms

- Historically, the trend of M&A transactions across borders was for developing country firms to buy companies in the developed world. In the past few years, however, we have seen companies from developing countries actually purchasing one another. India is no exception to this trend.
- Over the past decade, the significant attention that Indian firms have gained in the world economy is due in part to their M&A activities.
- Indian firms' outbound M&A activity gained significant traction beginning about 2000, and was at its peak in 2007 with a number of cross-border mega deals. In fact, the outbound acquisitions by Indian firms exceeded inbound investments by foreign multinationals into India in 2007 and 2008. Since 2009, there has been a dip in the total value of outbound M&A deals by Indian firms, perhaps reflecting the onset of the financial crisis.

II. Motivations for outbound M&A

- Western firms traditionally did outbound M&A deals to either grow in size or try and gain some efficiency.
- In the Indian context, however, there seem to be at least two different types of business motivations for these types of transactions: (a) search for research and technology or trying to access some kind of intellectual property that is essential to their business strategy and (b) seeking an established market.
- Most large Indian firms have begun to consider some level of overseas expansions as being critical to become globally competitive.

III. Regulatory reforms set the stage for outbound M&A

- The regulatory reforms in the early 1990s (such as economic liberalisation, and greater access to global and domestic capital markets) contributed to render the business and legal environment for firms conducive to do outbound M&A transactions.
- There was a series of reforms in 2000s that further facilitated M&As. In June 2000, the Government of India passed the Foreign Exchange Management Act (FEMA). In March 2003, the government significantly revised the 'Automatic Route' for overseas investment,

thus automatically enabling Indian corporations to fund 100% of their net worth abroad. The amount of remittances that could be sent back to India from foreign acquired companies was liberalised.

- Notwithstanding these reforms, there still remain regulatory restrictions (in terms of scope and size) on the ability of the Indian firms to fully realise their potential in doing outbound M&A transactions. Currently, for example, under the Companies Act, the merger of a foreign company with an Indian company is allowed, but an Indian company cannot be merged into a foreign company. In contrast, there is no such regulation in the US which limits the structure of outbound M&A deals.

IV. M&A and corporate governance

- The corporate governance (CG) in India has played a relatively complex role in cross border M&A transactions.
- Since the mid-1990s, Indian regulators have pushed through a series of fairly extensive CG reforms, which have undoubtedly assisted firms in attracting foreign capital; however, the role of these reforms in facilitating outbound M&A remains relatively understudied.
- There is a view that the relative inability of CG reforms to make a dent on the promoter controlled nature of Indian firms, has actually helped many family based firms to do cross-border deals, because decision making process in these firms is relatively more flexible and faster.

V. Legal landscape for outbound M&A

- Perhaps because of challenges in doing stock swap transactions in Indian context, Indian firms have primarily used cash for outbound M&A transactions which is neither desirable nor sustainable in the long-run.
- There are general restrictions on the ability of Indian firms to do domestic hostile transactions and this lack of experience has made the Indian firms reluctant to do hostile transactions abroad. Of course, there might also be important cultural reasons for Indian firms for not doing hostile takeovers in India or abroad.
- The merger regulations have come under criticism for their inflexibility and complexity. Like elsewhere in the world, in India the big question still remains as to whether the process of doing large-scale outbound transactions is going to face some resistance from the competition authorities.

VI. Performance of M&A deals

- Some outbound M&As are performing well, such as the acquisition of JLR by Tata Motors that has surpassed all expectations in terms of its performance. On the other hand, there are examples of fairly significant acquisitions that have been done based on poor judgement or some other reason, because of which they are not performing well.

- India is close to reaching a stage where there would be an important Indian bidder involved in any major M&A transaction in the world.
- While cross-border transactions involving Indian firms have been limited, Indian management talent has shown exemplary ability to reap the benefits of such deals, albeit not involving Indian firms. Mr. Lakshmi Mittal is a fantastic example.

B. Focal issues and suggestions on the regulatory barriers in outbound M&A deals

The panellists opined that India already has lots of regulations on M&A transactions and does not need more. However, a need was felt for a more relaxed and liberalised regulatory regime. The regulatory regime for M&A transactions is much simpler in other countries than in India.

I. Taxation issues

- Tax aspect is certainly a big issue in M&A deals because what profits the firm makes at operating company level is not necessarily what it gets at the investing company level. In India, taxation becomes an even bigger issue, because all the repatriations are taxed at maximum marginal rate of 33 per cent. It is really costly.
- To make things worse, there are no credits for the taxes paid abroad. This is the part of the reason why Indian acquirers do not bring the money back home. They would rather use it to retire debt and for retaining the profits over there for offshore acquisitions.
- A major tussle has resulted: Indian authorities wants the money to be brought back, while the acquirers want the Indian tax regime to be changed and made far friendlier.
- Nevertheless, India will hopefully matures to a stage where value creation out of M&A transactions is considered important transaction and not necessarily what is being brought back.

II. Financing issues

- There is an RBI regulation that effectively hinders for acquisition. It falls under the head of capital market exposure. Any financing that is given for the purposes of buying shares—which is typically how it is done, since asset purchases are done only very rarely—is prohibited. Thus ironically, ICICI bank can't lend from India for acquisition financing, but they can lend in London to an Indian company for the purposes of making an offshore acquisition.

III. Lack of disclosure

- Disclosure, typically required to be given to the shareholders, is inadequate in India. This is a striking distinction between the M&A regimes in India versus the U.S.
- The quantum of disclosure should hinge upon the object of disclosure: Is it to help investors on making investment decisions? Or is it for the purpose of some permission or consent that the firm requires of the shareholders to go forward with the transaction?

A. Welcome Remarks

- Nirmal Mohanty, Vice President, NSE

Good evening everyone. All our panellists are here, and we will be starting in a minute. Before we start, I will briefly present the backdrop of today's discussion. As all of you know, the NSE has held guest lectures and panel discussions from time to time, on topics related to securities markets, corporate governance, and macroeconomic issues. Today's discussion would revolve around outbound acquisitions by Indian firms. Let me explain the relevance of this topic to the securities markets. One of the ways in which exchanges make an impact on the macroeconomy is by improving the allocation of resources. Exchanges generate and disseminate enormous amounts of information, including firm-specific information, which get reflected in security prices. By providing clear price signals about the prospects of companies, sectors, crops, and so on, the exchanges contribute to better allocation of resources.

This is a pretty well known fact. What is not so well known, however, is that the exchanges also facilitate a free market for corporate control, which has a bearing on the efficiency of the past investment. The threat of a takeover improves financial discipline in corporates, and induces the management to use the company's resources in a more optimal manner. Takeovers can be internal or external. As regards external takeovers, a domestic firm may take over an international firm, or the other way around. What the panel is going to discuss today is about outbound acquisition by Indian firms in the overall context of mergers and acquisitions (M&A).

To put this in context, India embarked on a broad macroeconomic reform programme in the early 90s, which raised India to a high growth trajectory. We all know that the growth rate has slowed down in recent years but the vulnerability of the economy has reduced. One of the side effects of these reforms was that Indian firms came under international limelight, particularly as acquirers of foreign firms. By doing so, most Indian firms could establish themselves as multinationals. The increase in general M&A activity that took place following the liberalisation moves of the early 90s thus included a rapid expansion of outbound acquisition by Indian firms.

Indian firms have long been active in outside investments; they are now able to compete with the strongest multinationals in the developed countries. We are all aware of Tata's acquisition of Corus and Tetley Tea, and Hindalco's acquisition of Novelis. While these are some of the high profile cases, there have been several others. In the last decade, India's outbound M&A deals reached a fairly significant level. In her recent works, Professor Afra Afsharipour from the University of California, who is the main speaker this evening, has drawn attention to an interesting aspect of M&As, especially the outbound ones. She has argued that reforms in law have played a key role in the emergence of the Indian multinationals. She will be presenting her findings here today; subsequently, her findings and other related matters will be discussed by a set of panellists that includes a very senior official from the SEBI, eminent corporate lawyers, and a top executive from an Indian multinational.

Before I call Professor Afsharipour on stage, let me introduce her briefly. Afra is a Professor of Law at the University of California, Davis School of Law. She conducts research on comparative corporate law and governance, mergers and acquisitions, and transactional law. Her research has been published in a number of prestigious law journals. She is currently working with the Conference Board of the United States on a corporate governance handbook for the Directors of Indian public companies.

B. Presentation

- Afra Afsharipour, Professor, University of California, Davis School of Law

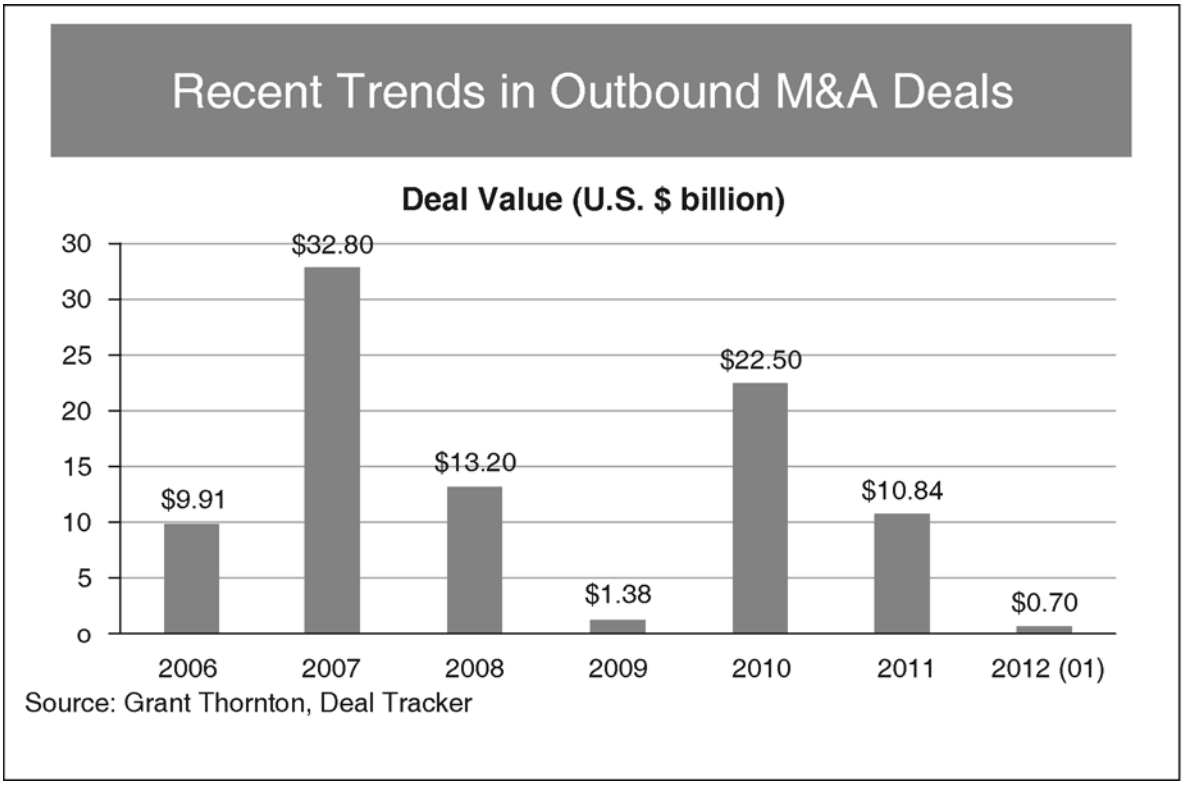
Thank you so much for being here tonight. My name is Afra Afsharipour, and I am a Professor of Law at the University of California, Davis School of Law. First, I would like to thank the National Stock Exchange for inviting me here today; I would particularly like to thank Mr. Nirmal Mohanty for all of his hard work in putting this session together. Well, I think this is going to be a fantastic panel discussion; I am very much looking forward to learning from our panellists.

Introduction

As you know, over the past decade, Indian firms have gained significant attention in the world economy. The rapid globalisation of Indian firms is due in part to their M&A activities. Mr. Mohanty mentioned some of the larger deals that took place; there were other deals such as Tata Motors' acquisition of Jaguar and Land Rover in 2008, which basically made the cover of all the business journals in the U.S. as well as in India. Such cross-border deals have gained a lot of attention for various reasons. Historically, the trend of M&A transactions across borders was for developing country firms to buy companies in the developed world. Over the past few years, however, we have seen companies from developing countries actually purchasing one another. India is no exception to this trend.

There has been a big change over the past few years. As Mr. Mohanty mentioned, the data shows that the Indian firms' outbound M&A activity gained significant traction starting in about 2000, and then picked up in 2005 and 2006. Below is some data on the value of these M&A deals over the past five years in terms of U.S. dollars. The deals skyrocketed in 2007 with an increase in the number of these cross-border mega deals. In fact, there was some evidence that the outbound acquisitions by Indian firms exceeded inbound investments by foreign multinationals into India in 2007 and 2008. The numbers certainly went down as a result of the financial crisis; in 2009 particularly, there was a large dip in the total value of outbound M&A deals by Indian firms. You can see that there was some pick up in 2010, followed by another dip in 2011. The data for 2012 that I have, is not particularly promising.

Some of this is just a reflection of the fact that M&A is currently down across the globe. It is not just Indian firms that are not doing outbound M&A deals; it has actually been quite a difficult time for M&A activities globally. I hope we will touch upon this during the panel discussion.



Let us look at how these deals have fared thus far. There is, in fact, very little empirical evidence on the returns from outbound M&A deals across the board. According to a recent report from *The Economist* (March 2012), not all of the four mega deals that were done over the past several years were totally successful. Of course, this data is very limited; it looks at returns on the EBITDA and changes in the EBITDA as a result of the deals, as well as current Returns on Equity. As I said, the data is very limited, and there hasn't been any comprehensive analysis of the returns from these outbound M&A transactions, especially if you look beyond these four major deals that were used as an example.

Performance of Major Outbound M & A Deals

Hello, cruel world

Performance of large Indian cross-border takeovers.

Buyer	Target	Annoucement date	Enterprise Value, $bn	Change in EBITDA*.%	Current ROCE!%
Tata Steel	Corus	January 2007	13.3	–54	1
Hindalco (Aditya Birla)	Novelis	February 2007	6.2	238	8
Tata Motors	3LR	March 2008	2.3	92	79
Bharti Airtel	Zain Africa	February 2010	10.7	–5	2

Source: Bloomberg company reports: analyst estimates

* Year before compared to estimated year ended March 2012: JLR uses adjusted EBIT.
†Tax adjusted EBIT estimated for year ended March 2012 compared with enterprise value paid

However, conventional knowledge—together with studies that have been done on M&A transactions across the globe—tends to show that large scale transactions, especially by publicly traded companies, actually lose value, at least when measuring value in terms of Returns on Equity. There is a paucity of research on whether this general wisdom actually holds true for cross-border transactions. One of the things that I hope Indian economists and finance professors will do is to examine the data from the cross-border deals that have been done by Indian firms. Several studies were developed in the U.S. that looked at outbound transactions by companies from developed countries, such as the U.S.; the results of these studies show that there were relatively lower acquirer gains, partly due to the acquirers' inability to correctly measure value or to capture synergies in the cross-border transactions.

A recent study by a group of economists in the U.S. that looked at general cross-border activities showed that acquirers from countries with better corporate governance standards gained more from cross-border M&A deals; in fact, the gains were higher if they decided to buy companies in countries with worse or lower corporate governance standards. Maybe, we could generalise these findings, and predict that we could expect good results if Indian companies were to buy companies in Africa and Indonesia, and bad results if they were to buy a lot of companies in the U.S. and U.K. There was also some evidence in the empirical literature that a better alignment of interests among the insiders, the controlling stockholders, and the minority shareholders was actually associated with greater acquirer returns. For some Indian companies, this would be good news, while for others, this would not be such good news. We can take this up during the panel discussion.

Business Motivations and Outbound M&A

We have senior executives here who can talk about the types of firms that have been involved in outbound M&A deals and the motivations for outbound M&A activities, in detail. A bit of background first: initially, the key markets of interest for outbound deals were located in the U.K., Western Europe, and the U.S. This trend has started to shift over the past several years; now, Indian firms have actually started to buy companies from outside the more developed world. According to the data that I accessed, most of the outbound M&A activity tends to involve private sector Indian firms rather than Government-owned or PSU-type entities. In terms of the business motivations for doing these types of outbound deals, most large Indian firms have begun to consider some level of overseas expansions as being critical in order to become competitive globally.

Western firms traditionally did outbound M&A deals in order to grow in size or to try and gain some efficiencies. However, there seem to be at least two different types of business motivations that are at play in these types of transactions in the Indian context: one involves the search for research and technology; the other involves seeking an established market. The first type involves trying to access raw materials or technology, or trying to access some kind of intellectual property that is essential to their business strategy. Tata's purchase of Tetley Tea—a well-known tea brand with a relatively large consumer base—can be treated as a business motivation for doing outbound M&A activity. Over the past several years, more and more Indian firms have started to purchase companies in countries such as Australia, Indonesia, and Africa. There has been a push in terms of trying to seek resources, particularly the kind of energy resources available in those countries.

Setting the Stage for Outbound M&A

In the 80s, outbound M&As by Indian firms were relatively non-existent. The changes in the regulatory landscape really contributed to the increase in outbound M&A; these changes included greater economic liberalisation, and access to global and domestic capital markets, which facilitated the raising of funds to actually do these types of deal.

Traditionally, most commentators viewed the period of the License Raj as detrimental to the Indian economy and to outbound M&A transactions. I think the story is a little bit more complicated than that. I think, in fact, there could be an argument that the relatively protectionist period that was in place then may have set the stage for outbound M&A acquisitions: since Indian companies were shielded from the rest of the world, they were able to sustain domestic growth, increase corporate earnings, and strengthen their balance sheet. This may have actually allowed Indian companies to become relatively cash rich. Subsequently, the dismantling of the License Raj made the situation favourable for them to do outbound M&A transactions.

We will discuss India's economic reforms during the panel discussion, especially a number of important reforms that were specifically aimed at allowing Indian firms to do outbound M&A deals. The Indian Government passed the Foreign Exchange Management Act (FEMA) in June 2000. In March 2003, the government significantly revised the "Automatic Route" (i.e., without prior government approval) for overseas investment, thus enabling Indian corporations to fund 100% of their net worth abroad. The number of remittances that could be sent back to India from foreign acquired companies was liberalised. These were all critical changes that helped to create the business and legal environment for companies to do outbound M&A transactions.

Obviously, economic reforms and liberalisation have been very important in facilitating outbound M&A deals; but there continues to be restrictions on the ability of the Indian firms to fully realise their potential in doing outbound M&A transactions. By 2010, for example, Indian firms were permitted to invest up to 400% of their company's net worth. While the ability to invest up to 400% of a company's net worth is certainly a benefit for conducting an outbound M&A transaction, it is also a restriction on the ability of Indian companies to turn to investment activity abroad and on their ability to do outbound M&A transactions. This limitation, along with the inability to pledge Indian assets for guarantees or for debt financing without some level of approval from the RBI, actually makes it fairly difficult to be more creative in the scope and the size of outbound M&A transactions by Indian firms.

I think domestic and global economic conditions also played a role in facilitating outbound M&A transactions. Indian firms were able to raise acquisition financing abroad; there has been a relatively good appetite for Indian paper, both debt as well as equity. This may not continue to be the case; in fact, the recent capital market inactivity, together with various RBI restrictions, might actually make it fairly difficult to do outbound M&A transactions.

The Legal Landscape for Outbound M&A

In addition to the legal rules that set the stage for outbound M&A transactions, several other aspects of law in India affect the structure of outbound M&A transactions, and in some ways the potential for outbound M&A transactions. In my academic papers, I have argued that the Indian legal norms and the legal system help foster the development of companies that have expertise in M&A transactions by virtue of doing a lot of domestic M&A deals. Most of the companies that have been involved in doing outbound M&A transactions were first involved in doing domestic M&A transactions, and thereby, gained a lot of expertise in M&A.

I. The Companies Act

Nevertheless, Indian laws still place significant restrictions on the potential of Indian companies to do M&A deals. I will give one example of a particular set of laws in the Companies Act that has thus far restricted the structure of outbound M&A transactions. Committees, such as the Irani Committee, as well as I have recommended that this set of laws needs to be changed.

Currently, under the Companies Act, the merger of a foreign company with an Indian company is allowed, but an Indian company cannot be merged into a foreign company. Compare this with the regulations in a country such as the U.S., where there is usually no restriction of this sort which limits the structure of outbound M&A transactions. The recommendation of the proposed Companies Bill, placed before the Parliament, is to permit the merger of a foreign company with an Indian company and vice versa, with two limitations: the foreign company must be located in a country that is being notified by the Central Government; and prior approval would be obtained from the RBI. It is unclear how significant these limitations will be, and therefore, it is unclear as to how much of a change these will bring about.

A couple of other recommendations were proposed by the Irani Committee, which are not reflected in the Companies Bill. There is, however, a push towards a general opening up of the markets to allow a lot more flexibility in the structure of M&A transactions.

II. Limitations on Stock-Swap Transactions

Another important aspect of the legal landscape in the context of outbound M&A deals is related to the limitations on the ability of Indian companies to do stock swap transactions. While the deals done by Indian firms were quite substantial in size, especially the deals in 2007 and 2008, the transaction-specific characteristics were relatively mundane in terms of the types of transaction structures that were used. Unlike many international M&A transactions which feature stock swaps, Indian acquirers have paid cash for the targets, for the most part; this might be because these companies are cash rich. This might also be due to the challenges in doing stock swap transactions in the Indian context.

I won't get into all the complexities of the Indian regulatory regime. The Indian regulatory regime has generally made it difficult for firms to use shares—which tend to be relatively common acquisition currency across the globe—as consideration in an acquisition. Indian firms have primarily used cash as acquisition consideration. This is not because stock swap deals are unlawful; it is really more because they are difficult and risky to implement due to the significant role played by the Government in these types of transactions. Many of the lawyers that I interviewed, who were involved in Indian firms' outbound M&A deals, were of the opinion that the need for various approvals from the regulators, as well as the various valuations and so on, led to significant regulatory uncertainty in doing stock swap deals. It could be argued that the Indian firms are perfectly fine doing cash deals, and that it is not important that they haven't done stock swap deals thus far. This argument is good only as long the economy is doing relatively well and you have access to cash; it does limit the ability to actually use an important currency that companies have—their shares—to do these types of deals.

I will talk about this again when I discuss the corporate governance issues related to outbound M&A deals. While there are some indications that overseas sellers of companies are hesitant to invest through the stocks of firms that they perceive may not always be run professionally, this is almost certainly not true for all Indian firms. There may not be a tendency for overseas investors to invest in Indian companies using Indian stock; they would probably prefer to get the cash, and invest the money elsewhere. However, over the long run, I think it is neither desirable nor really sustainable for Indian firms to continue to use only cash as the acquisition currency for outbound M&A transactions.

III. The Takeover Code

While the provisions of the takeover code do not directly apply to outbound acquisitions, I argue that actually they have a significant indirect influence on Indian companies, and would like to briefly discuss this today.

On the one hand, Indian firms launched outbound M&A deals with a deep understanding of the complexities of takeover rules. On the other hand, the complexities of the takeover code and the fact that the law tends to be relatively promoter-centric or promoter protective means that there are general restrictions on the ability of Indian firms to do hostile transactions. Part of my argument is that Indian firms have been reluctant to launch hostile transactions abroad because they don't really have the experience of doing domestic hostile transactions. This might actually make it challenging for firms to take on a transaction activity that is in itself quite risky, if they haven't been involved in doing such transactions domestically.

I won't have enough time to get into the various criticisms of the code, but it has certainly been one of the reasons for the lack of hostile takeover activity by Indian firms. Of course, there might also be important cultural reasons for not doing hostile takeovers in India, which might play a role in not doing hostile takeovers through outbound transactions. A lot of the time, buyers do not want to be perceived as being hostile, as being abrasive. They would much rather have the target company sit at the table, and have a relatively friendly transaction in order to see the deal through, which is more of a cultural thing.

IV. The Competition Act of 2002

The Competition Act of 2002 also mandates merger regulation. There was some level of uncertainty as to how the merger regulations were going to apply to outbound deals, given that there were very few outbound deals over the past year and a half. The merger regulations have come under criticism for their inflexibility and complexity. The CCI has made some amendments to address concerns that were raised regarding the merger regulations. It was still not clear whether the merger regulations would stand in the way of outbound transactions, or whether there would be increased transaction costs when it came to outbound transactions. The big question still remains as to whether the process of doing large-scale outbound transactions is going to face some resistance from the competition authorities, especially if the deal has a significant impact on competition in India. This is a general concern that we see across the globe with respect to competition law more generally.

M&A and Corporate Governance

I'd like to briefly talk about corporate governance issues and outbound M&As. Similar to the role played by the transformation of legal rules governing M&A transactions more generally, the transformation of corporate governance in India has also played a relatively complex role in both facilitating as well as hindering outbound M&A transactions. Since the mid-nineties1990s, Indian regulators have advocated and pushed through a series of fairly extensive corporate governance reforms, and challenged the traditional model of Indian firms. Changes include requirements for majority Independent Directors and, in certain cases, the requirements for majority independent audit committee. Some commentators have argued that despite some of the shortcomings in the actual implementation and enforcement of these corporate governance standards, India's extensive corporate governance reforms have contributed to the rise in outbound M&A activity by encouraging foreign investments in various sectors and industries.

I have seen some reports from business leaders arguing that the corporate governance reforms have helped to attract international investments, which has made it easy to raise funds in order to actually be able to do acquisitions. India's corporate governance reforms have undoubtedly assisted firms in attracting foreign capital; however, I think that the role of these reforms in facilitating outbound M&A remains relatively limited and understudied. We really need to look into it much more to understand the significance of governance reforms to M&A transactions. As I have argued in different contexts, the governance reforms in India remain somewhat aspirational rather than operational, and they have yet to take on promoter controlled nature of Indian firms. Of course, it can also be argued that the promoter controlled nature of Indian firms is partly what has allowed large M&A transactions to be done relatively quickly.

Promoter-control may actually have a positive effect on outbound M&A deals. The argument is that if there is domination by a particular controlling stockholder, a much more flexible decision-making process is possible in the M&A context.

In the U.S. market, you may have followed Facebook's recent IPO as well as their acquisition of Instagram prior to the IPO. The entire deal was negotiated by Instagram's Senior Executive Officer, their CEO, and their promoter with Facebook's controlling stockholder, Mark Zuckerberg, over set of meetings at his house that lasted for 2 days. The argument is that Zuckerberg was able to acquire a really important company—one that can be an important technology for Facebook going forward—without all of the checks and balances, and other costs that companies generally tackle in M&A transactions. In a sense, his control over the company allowed for more flexibility in doing M&A transactions.

In the Indian context, companies with controlling stockholders or companies with promoters can afford to take the risk that the stock price may dip in the short run, because they can stay in the business in the long run to actually see how the M&A transactions perform over a longer period of time. So that's kind of a general argument regarding the push for promoter controlled firms and outbound M&As.

However, I think it is a double-edged sword because it also means that the promoter controlled nature of Indian firms and the relative weakness in the proper governance standards play a role in actually making Indian stock relatively unattractive to investors from countries with better corporate governance standards. In fact, the promoter controlled nature raises governance concerns in terms of thinking about the adaptability of leadership transitions, checks and balances and transparency – – things that are mainly involved in effective integration after a M&A transaction.

Board involvement in risk management and M&A has been under focus across the globe; the U.S. in particular is really thinking about the long-term risk management of M&A transactions. The level of actual risk management that gets done by boards across India, as well as the envisioned risk management process of running both the M&A deals as well as the integrations deal afterwards, is unclear to me. In terms of shareholder involvement, I had asked whether large foreign acquisitions actually created shareholder value. I am not sure that Indian shareholders necessarily care that much; but certainly in the U.S. context, about 90% of all M&A deals lead to litigation. I don't think the number will ever approach this in the Indian context, although there is some shareholder activism in India.

As you continue to have shareholder advisory firms in India, and as there are greater roles for institutional investors, there might be a situation in the future where there might be more shareholder involvement, with the shareholders wanting a say in outbound M&A transactions.

Conclusion

Before I wind up, I would like to pose some research questions, because there is so little research on outbound M&A deals by Indian firms. The big research question, I think, is: Do we need law reform? I think we really only need it if we think that the deals are performing, and they are worth doing and are worth facilitating. There are a lot of questions about whether these deals are performing in the long run. I think the data is relatively new and the deals are relatively new, so it is a little early to tell. Further, there is also obviously the question—which is a problem across the globe: How do you measure whether a deal is a good deal or not? The measurement aspect can be quite difficult.

I talked about some of the restrictions in Indian law, particularly those dealing with stock swap transactions. I hope the panellists can discuss what kinds of law reforms are needed and whether they will actually get done, and from a corporate governance standpoint, whether the structure of Indian firms and the controlled company aspect of Indian firms are conducive to doing lots of outbound M&A deals. I have really only scratched the surface on a very vast topic, but I hope there is enough food for thought. Thank you.

C. Panel Discussion

Moderator: **Afra Afsharipour**, Professor, University of California, Davis School of Law

Panellists: **V. S. Sundaresan**, Chief General Manager, SEBI
Cyril Shroff, Managing Partner,
Amarchand & Mangaldas & Suresh A. Shroff & Co.
D. Muthukumaran, Head of Group Corporate Finance, Aditya Birla Group
Sandip Bhagat, Partner, S&R Associates

Moderator: I would like to get a sense of how each of you panellists perceive the level of outbound M&A deals, as well as the relative success of such deals. Obviously, some of this is not everyone's specialty in terms of what they may have studied. We have certainly got a mix of panellists—people who have actually done outbound M&A deals, as well as people who are generally very active in the markets in India and have a good sense of what's going on with Indian companies. Given your past expertise in actually doing such outbound M&A deals, I would love to get your input about how you believe they might be performing overall.

D. Muthukumaran: First of all, I would like to thank the National Stock Exchange and Mr. Mohanty for having me over. I would like to give both a short answer as well as a long answer to what you asked.

The short answer is: I think it is a little too early to pass judgement and say that these deals have not been worthwhile; there are early signs of these acquisitions clearing the intended return hurdles in times to come.

The long answer is: I think, outbound transactions are going to be part of the evolution that you talked about—from License Raj to pre-capital market and the global village concept. Imagine: if there were no M&As or integrated globalisation, we would still be consuming Gold Spot instead of Fanta; we would still be driving a Fiat instead of the various brands of cars that we have in India today and we would still be spending INR 16 for a minute's phone call. Instead, see where we are today.

I think it is an inevitable part of the journey, and the globalised operations do give the platform for companies to innovate and serve the consumers. Therefore, it comes down to the question of whether you are going to hunt or be hunted, or whether you are going to consolidate, or be consolidated.

I am from the camp that believes that companies will see more outbound acquisitions over a period of time. I think we already have an adequate regulatory framework, and the platform, and the ability to do the transactions. However, it is the legal framework that needs to run ahead of the actual transactions that are happening. To that extent, whatever is required—the areas that you mentioned—can accelerate. In terms of actual success, I think the best measure is return on capital employed, or EBITDA growth.

What we never get to see is the opportunity cost of not doing a transaction; and I think it is extremely difficult to measure the consequences of not having a consolidated industry. It doesn't matter what industry we are talking about—whether it is retail or manufacturing or services, whether it is scientific research-based pharma, or technology sophisticated industries or mass manufacturing industries —I think it is very difficult to measure the impact of not having a consolidated industry. I have been doing M&A for the past 15 years, and I feel that the best measure of actual value creation is return on capital employed. I saw in your report that you have put the Novelis EBITDA as 238% of what it was when we acquired it. The story is similar in our other transactions as well. So, I think that it is early days yet; but we seem to be on the path to actually achieving the intended purpose of outbound M&As.

Moderator: From a regulator's standpoint, do you see outbound M&As as positive, as something that you would like to continue to facilitate, or is this not the case?

V. S. Sundaresan: Good evening everyone. First of all, I would like to thank the National Stock Exchange and Mr. Nirmal Mohanty for inviting me to this panel discussion. Being a regulator, the first thing I would like to make clear is that all these are my personal views, and my employer may or may not subscribe to them.

As far as M&A activity is concerned, as you said earlier, it gained momentum after the liberalisation process started. I will classify this 20-year process into 3 types of segments, beginning with the period from 1991 to 2003, which I will call the "cake cutting" era. What I mean is this: when the Indian market was opened up to the world, there was scope for acquisition in India, and so the foreigners came inside and they started this activity. It actually opened up possibilities for the Indian companies; as was rightly said earlier, these companies realised their own potential to go outside India.

The second segment is 2003–2009, which can be called the "back to back" era. I got this idea from an article, and it perfectly suits the statistics that you had shown earlier. For instance, in 2007–2008, the outbound activity was much more than in the previous years or in the later years.

The period between 2009 and 2012 appears to be more sensible, and so it can be called "sanity returned the morning after". The people involved have better realised the potential of going out, and the pros and cons of continuing to do M&A activities inside. What I see from some of the literature is that people are moving towards developing countries rather than to the developed countries. I think corporates feel that the potential in other developing countries is much more than what they could perceive in a developed country.

As far as the regulator is concerned, we have no objections to anybody going and doing any outbound activity; if it is a listed company, it has to comply with the Listing Agreement and make appropriate disclosures at the appropriate time. Beyond that, as a regulator of the securities market in India, we have absolutely no objection to such transactions, and if any corporate feels that there is anything we can do for them, we are always open for a discussion.

Moderator: What is your perspective in terms of how the deals have been performing, as well as the trajectory of the deals going forward?

D. Muthukumaran: If you look at outbound acquisitions, it is simply the converse of FDIs. The answer to your question of how outbound M&As are performing is almost identical to that of the question of how inward acquisitions are performing. The answer is that some are performing well, and some are not performing well. There are some very successful acquisitions; JLR is one example that has surpassed all expectations in terms of performance. While I don't want to mention names, there are some examples of fairly significant acquisitions which have been done based on poor judgement or some other reason. They are performing very badly.

That is probably the same answer you would get if you went outside India and asked how Indian inbound M&As are performing. It is a mixed bag.

There is another angle to it: I think you may really want to look at outbound M&As as work in progress. The original purpose of the Indian companies getting involved in such acquisitions was to create shareholder value. We have reached a stage where in any major M&A acquisition in the world, there would be an important Indian bidder involved. Whether it has actually created wealth or not remains to be seen.

Another important contribution is our managerial talent; they have gone out there and got into companies and turned them around successfully.

So a lot of companies have Indian managerial talent in them and have created wealth at the target company level. Mr. Lakshmi Mittal is a fantastic example, although technically, his acquisitions do not fall into the category of outbound acquisitions. But Mr. Lakshmi Mittal is an Indian export, if you look at it that way. And he has been able to turn around so many companies around the world. So at a very philosophical level, you can look at it as outbound acquisition. And thus we have created wealth.

Moderator: A quick comment on your statement about Indian management. There is a book called *The India Way*, which has actually become a phenomenon in the U.S. Various business schools have been discussing the Indian way of managing companies. Sandip, can we have your views on this?

Sandip Bhagat: Thanks, Afra. I don't think I have much to say in this particular context; but as a practising lawyer—and this ties in with what Mr. Sundaresan said earlier—I think even in early 2000s, when we were practising law, we really didn't get hired for outbound M&A, or for assisting in structuring such transactions for companies in India.

Until about early 2000, legal counsel would not consider India as a market that would generate active business activity on outbound M&A. I think that changed around 2003, especially from an Indian legal perspective. To put it simply, the main Indian law issue when dealing with outbound M&As—and I am ignoring board/corporate approvals because every company may need that for any transaction—is the FEMA and the foreign exchange regulations. The regulatory change in 2003, which further liberalized outbound acquisitions under the automatic route, increased outbound activity.

I think, certainly, there was enthusiasm. Especially when the Tatas and the Birlas started doing major transactions, every other CFO and every other promoter started to wonder: are we missing out? Should we be doing the same thing? And India started seeing increased activity, which I think has scaled back a little over the past two years, when companies went back and began to realise that they may not necessarily have lost out on such acquisitions.

The one question you can probably ask is: where actual acquisitions have happened? Did the acquisitions succeed? I do not know if you will really get hard empirical data on that. I understand that there were about 1100–1200 acquisitions last year itself, which is a fairly large number and not all of them made headlines. Acquisitions continue to take place. But the question remains – did they succeed, was it worth it?

Moderator: You started off the discussion on FEMA, which I had talked a little bit about during my talk. What are some of the challenges to doing outbound deals or structuring outbound deals in different ways? From a practice standpoint as well as from a corporate standpoint, what do you think are the major regulatory hurdles or barriers? What would you like to see changed?

Sandip Bhagat: The FEMA is a set of regulations, which you could argue is restrictive; but it is what we have to comply with as a regulatory and policy matter. I think what Cyril may probably talk a bit more about is the regulatory issues permitting certain kinds of structures. We have been hearing that the Reserve Bank of India may be considering that companies should approach the RBI for approval for every acquisition. One hopes it doesn't move back to that and the automatic route remains.

In response to some of the issues that you raised, we spent time some years ago to try and structure cross-border transactions where an Indian listed company could issue its shares in a stock-for-stock transaction. It is a fairly complex structure, partly because of the exchange control regulations. One structure was that the Indian company issued listed liquid securities, such as ADRs and GDRs, to the entity outside India and in return acquired listed shares of the overseas entity. For this structure, in addition to the FEMA issues, the Indian takeover code, the insider trading and other SEBI regulations also come into play. At a more basic level, another question was: can you have Indian listed shares issued directly to the public shareholders of the overseas listed entity?

Having worked in the U.S. myself, I certainly think it is a much simpler regime outside, because you don't really have to think about most of the exchange control issues on the corporate front; you may have to think about the business judgement rule in the broad corporate context. In the Indian context, there are also other issues to consider. You cannot merge an Indian company into a foreign company; therefore, you would need to incorporate a subsidiary. Companies may prefer to have the financing outside India than to finance in India. Also, for guarantees, the Indian company can only guarantee the entity in which it has an equity interest; to guarantee 2–3 levels below, we need to interact with the RBI.

Moderator: Cyril, could we have your thoughts on this?

Cyril Shroff: First, let me talk about what's growing at this point, and then I will go back and examine the framework to build on. And this is in the public domain, as you might have read about it. In April, there was a meeting at the Reserve Bank of India in consultation with industry and the private sector, which culminated in a lot of internal debate about whether Overseas Direct Investment (ODI) has worked or not, and what should the policy or framework be going forward. The direction that the internal debate took was that even though 95% of the transactions would be automatically looked at, 5% evading the approval rule was not a good idea. Going forward, all transactions should be brought under the approval route. There were various opinions in the private sector consulting with the RBI regarding this, which can be interpreted as a raw signal to make this change.

A request was sent to the Ministry of Finance in Delhi asking them to confirm that they can now denotify the automatic route. Everything under the approval route with 400% net worth criteria would still apply. However, the manner in which this was calculated would change, because the net worth of the subsidiaries—the offshore subsidiaries—would also be added. There would be no multi-layered complex structures unless they had operations under the preapproved regime.

Essentially, there would be a lot more reporting back also, if this goes ahead in this form. I believe this would mean the end of the era of outbound acquisitions as was seen in the last 8–10 years. It would get so cumbersome that the speed and flexibility with which Indian companies have been able to participate in offshore M&As would dramatically slow down. It is a complete reversal of the policy that has been followed so far, if it is also combined with the notion that no cascading set of SPVs—which is one of the prerequisites for financing offshore acquisitions—will be allowed. Unless it is an operating company at each level, the structures would not be allowed. If this goes ahead, it would mean that banking markets would refuse to touch some of the financing structures suggested by Indian promoters.

So either you can do it out of your own 400% net worth or you can have specific financing that is raised on the strength of the operating company.

The risks that the international bankers see on a bare acquisition SPV and on operating companies are completely different. So I hope it doesn't proceed in this direction. If you put FDIs under the automatic route, you know what the impact will be; it is conceptually almost the same as what was said earlier. One possible reason could be some bad incidents where people have used the automatic route to do all sorts of stuff. I think the response should be to find out what they have done, go after them, and send them to jail.

The second reason could possibly be that the complex structures allow companies to hide overseas profits, which is neither a great idea for the Indian minority shareholders nor a good idea from an exchange perspective. We cannot forget that we are still a nation which has many controls on capital account. I don't necessarily agree with the remedy, but I can understand where it is coming from.

And the third reason is just an inherent suspicion that all regulators including the SEBI have about complex structures. The moment you see 15 SPVs with crossholdings at various levels falling down, the first instinct is that there is something fishy going on over there. So there is an inherent instinctive rejection of anything complex. Now there are white sheep as well as black sheep in the market, so we have to find a way of dealing with the black sheep. The result of this is probably going to be that all the normal business activity of the white sheep will also be put in the same queue as that of the black sheep. And in the end, I think India is going to come out a loser because if I am sitting in an option, in forums, where I am selecting a buyer—a Chinese buyer, a Brazilian buyer, an Australian buyer, an Indian buyer—the question every potential buyer is going to be asked is: Have you got home country clearance? The potential Indian buyer would still have to go and ask somebody, and I don't know how long that will take. The first thing I would do as an investment banker is to get the Indian out of the room, and talk to the people who can actually go through with the transaction.

Moderator: So as the white sheep, what's your response?

D. Muthukumaran: I will first respond to your question about the role of regulation in an outbound M&A before getting down to specifics. I think as a business manager, the best way to look at regulation is as a process that you need to comply with. There are a lot of complex regulations, but in my view, Indian regulations are only one part of the issues to be tackled. Chances are that we will not know the target country's regulation as much as we will know Indian regulation. We are most familiar with Indian regulations as we embark on the transaction. Without undermining the points that Cyril made with respect to the general regressive nature, the fact is that when you are evaluated by the target company, you don't want this handicap. The good news is that such onerous and often illogical laws prevail in most countries, and we all learn to deal with it.

So from our point of view, unless we are doing something that is not correct, you will find a way to address these regulatory issues. It just becomes a matter of time rather than an issue of outcome. I am not in favour of arguing for more regulations. I think we already have lots of them, and I think there is a definite case for a more relaxed and liberalised regulatory regime.

Now to answer your question about outbound regulation, from a regulatory point of view, the RBI is at the top of my mind, because the doability is determined by the restrictions imposed by the RBI. Once you pass that filter, we need to look at taxation because that's a very significant regulatory issue that one comes across. And it often goes into the value calculation as well, because what (profits / value) you make at an operating company level is not necessarily what you get (at the investing company level). So tax is certainly very important.

The third most important filter is actually financing. This is where I think India could certainly do with a more liberalised regime. You did talk about shares swaps and restrictions on loans against shares. A liberalised environment will open up options for Indian corporates to do more M&A transactions, which actually will give them more competitive strength against other potential buyers. And it would lead to more flexibility. So we can do definitely with a more liberalised regime on capital and financing regulations; that's the third important regulation.

There are a few other regulations that have nothing to do with the M&A process itself but with the evaluation of a strategic transaction. Often, the target country's regulation is very crucial, especially if we look at multi-country operating targets. From an acquirer's standpoint, the interface between the target company's regulation and our regulation is very important.

Another extremely crucial aspect that doesn't get covered in the M&A process itself is the regulations around environmental, health and safety. Obviously, environment is an issue to which various Indian companies don't have as much exposure as some of our competing bidders have.

And, it can actually be a very big issue, especially if we end up buying targets in developed countries where environmental regulations are on the over-regulated side, which means a lot of costs, and potentially a lot of settlement damages as well.

So there are lots of regulatory issues that one needs to look at for target evaluation. I think, as Indian companies grow larger, we will get exposed to these issues and we will get familiar with them and learn to deal with these issues. And as some of the panellists said, our group actually have the advantage of size. Some of the smaller companies will take time to learn about some of these issues. So, I think the regulatory framework for M&A is more complex than the M&A processes.

Cyril Shroff: I would like to add two comments to what was just said. Firstly, to give a sense of the gravity of the tax issue, think of a foreign target with 100 units of profit. First, it would suffer one level of taxation in the home country, which can vary (it could be around 30 or 40 or 50%). Some markets in Europe have 50% taxation; i.e., out of the 100 units, 50 are gone. When the profit is sent back as dividend, unless the rules change here, it would attract more than 30% tax in India. So out of the original 100, 50 are gone in the home country, 30 are gone in India; what is left is about 20, which is absurd. It is almost like an 80% level of taxation; plus, there is no credit system available. This is the legal reason why Indian acquirers do not bring the money back home. They would be using it to retire debt and for retaining the profits over there for offshore acquisitions. This is one of the main tussles that are going on, where India wants the money to be brought back, while the acquirers want the Indian tax regime to be changed and made far friendlier.

The second point is meant to supplement what was mentioned earlier about financing. There is a Reserve Bank of India rule where acquisition financing is effectively barred. It falls under the head of capital market exposure. Any financing that is given for the purposes of buying shares—which is typically how it would be done since asset purchases would be done only very rarely—is prohibited. So ironically, ICICI bank can't lend from India for acquisition financing, but they can lend to Mr. Birla's company in London for the purposes of making an offshore acquisition. This means that you necessarily have to house your financing structure offshore, in which case you get into the complex SPVs format for both tax as well as financing reasons; and then, the new regulation comes into play. I don't know what the solution is going to be; it would probably be equity financing.

D. Muthukumaran: I would like to add to both the points that you made. As far as taxation is concerned, I think there is an immediate issue and there is a broad philosophical issue. The immediate issue is a burning issue in India, so I am probably touching on a very sensitive subject. We certainly want all the dollars; but the reality is that wealth doesn't have to be measured on the basis of what you bring back into the account of the company from where it was despatched. It is all in the same company on consolidated basis; it doesn't matter whether it is a holding company or a subsidiary company. Often, people will take the decision of whether to leave it in a subsidiary or bring it back to the holding company based on larger issues such as what they are going to do with the capital and where they are going to use it. It is an immediate issue for India, to actually to bring that much money back; but philosophically, I don't know whether Pepsi US measures wealth creation of its international business according to how many dollars were put in and how much was brought back. I mean, you always measure what you took and the value today. I don't think a Swiss MNC or a Chinese MNC will measure wealth on the basis of what was brought back to the home country. I think we will hopefully grow to the stage where we say that what is important is the value that is created, and not necessarily what is in the bank.

Second, I think the tax aspect is certainly a big issue. In India, it becomes an even bigger issue because all are taxed at maximum marginal rate — i.e. we tax all the repatriation beyond capital or sometimes even capital that is foreign dividend at 33% tax. It is really costly; and to make things worse, there are no credits for taxes paid.

As Cyril pointed out, by the time you bring 100 units back into India, it is going to be only 20. So why bother bringing it back? One needs to come up with a solution that is similar to what has successfully been used in many developed countries, which is the base for some of the MNCs. And hopefully this will create a platform for some of the big Indian companies to become Indian MNCs.

From the financing point of view, we already have a very restrictive environment in India, and adding more restrictions would only make it more difficult for Indian companies to do financing. It would make the process far more complex and uncompetitive for some companies. It would be easy for bigger companies to address some of these issues, but it is not going to be useful for the vast majority of smaller companies who are aspiring to be global companies.

Moderator: Sandip, do you have anything to add from your client experience, from the perspective of financing?

Sandip Bhagat: I think there are restrictions and due credit goes to the Indian corporates who have managed these many acquisitions. When we are trying to structure overseas transactions, we are looking at solutions such as obtaining financing outside India. This also depends upon various factors, such as for example, the assets outside India. I think the smaller companies may struggle more, and perhaps that is the philosophy of the regulator, including imposing limits such as 400% of net worth, etc. You first grow up, become a larger company and then they will permit you to undertake certain transactions outside India.

Moderator: So one of the things that strikes me when I look at U.S. transactions versus Indian transactions is the lack of disclosure in India, which is generally required to be given to the shareholders. In the U.S., there is a relatively robust disclosure regime. Could you touch upon the philosophy behind disclosure in terms of outbound M&A? For example, in the U.S., when you do a significant M&A transaction, you file disclosure about the transaction; you file the Form 425; you file the PowerPoint slides regarding the transaction; you file the actual acquisition agreement, which is very easily publicly accessible. And there seems to be a significant difference in terms of disclosure regime compared to the Indian context. Would you see that changing with respect to those companies?

V. S. Sundaresan: I feel there is no specific description regarding disclosure of an outbound acquisition or inbound acquisition. According to the Listing Agreement, materiality needs to be disclosed. It is left to the company to decide what materiality is, and to make a disclosure. So there is no specific disclosure imposed on an outbound activity or an inbound activity. As long as the disclosures are made, and the information is made known to the public, and no entity with sensitive information trades on that information, there are no restrictions. We have not distinguished any percentage or value or investment type for inbound or outbound transactions. It is absolutely neutral; the focus is on whether it is price sensitive. If it is a listed company and it has price sensitive information, there are certain restrictions regarding the stage at which it would be disclosed. And if it is not disclosed, the people who are privy to the information are not supposed to trade on it or counsel anybody regarding it. So except for this, I do not think there are any other restrictions.

D. Muthukumaran: I am not commenting on the rigour involved in disclosure. For example, there are stock exchanges that believe that you should suspend trading when there is a potential transaction that got leaked out. However, there are also stock exchanges that don't believe in this philosophy, and they simply say that it is enough if you say that you are in discussions with potential strategic parties. If you have to actually disclose the nature of the discussion that you are having with counterparties, you would lose the competitive edge in an auction process. The entire purpose of an auction process is to get the best price for the seller. If you end up saying that you are talking about a transaction, and this is the transaction, and these are the total number of parties, the only thing that is left undisclosed would be who they are. Then where is the benefit of auction?

The U.S. companies, for example, may have to go through the cookie cutter formula to prove that you have got the best deal. So a deal is good or bad depending not just on the headline number of price; there is price on their own terms. So if you had to align everybody to the same terms, you lose potential bidders in the process. So is it good? I can make an argument that it is not necessarily good to use a cookie cutter to evaluate the deal. If you have to disclose everything in the process that is happening, then you have lost competitive edge.

If there is irrational price behaviour, the level of disclosure is different. We were involved in a situation where over-disclosure actually killed the deal. As a potential buyer, we lost; but we lost only an opportunity, while somebody else has actually lost real dollars. So I don't know what the fine balance is in determining the correct disclosure norms. I do think there has to be sanctity or secrecy up until you close a transaction. If you are going to actually do everything in an open auction, you will not necessarily get the best deal.

All these are done to ensure that you protect the investor's interest. So, long as you do that, it's fine. You can control it in many other ways.

Sandip Bhagat: As Mr. Sundaresan said, I don't think it is a question of outbound transactions; it is more a general principle: How much do you disclose when you are doing an acquisition? I think there are certainly issues to be considered (e.g., Should you be disclosing at the MoU stage?) that I think can be addressed. Generally, disclosure in India is poor, for various reasons. I think the Listing Agreement describes material events. Nobody has really given guidance to corporates about the main material things to talk about while doing an acquisition—the consideration, what percentage equity is being acquired, details about the business and so on. As a practitioner, I can say that once we have gone into a discussion with the client who is doing a potential acquisition, the sensitive issue of how much should be disclosed arises. There is always a comparison with what others are giving in the market.

And I think that has to be changed. I would say at the stage where we are in capital markets, I think the change has to be led by the regulator, where they specify for certain kinds of transactions, this is what you need to disclose; or they provide some general guiding principles as opposed to putting it down in law.

We don't have a requirement to file material agreements in India, except at the time of an IPO. So I think that should be a requirement; I think it is in the regulator's court; it is up to the NSE, the BSE, and the SEBI to decide where they want to go with that. I think there is some balance you can achieve.

Moderator: Before I open it up for Q&A, Cyril do you want to add anything to that?

Cyril Shroff: I agree with what he said, but I think it is important to make the distinction between keeping secrecy during the bidding stage (it may impact the outcome), and then effectively the host signing or closing disclosure. But the question that I have in my mind is: What is the consequence? Are you disclosing to simply provide information that is out there so that the investors can decide how to trade? Or is it for the purpose of some permission or consent that you require of the shareholders to go forward with the transaction? I can see the logic if there is a stock swap and they are going to issue new securities from the company, you would need to take the shareholders of your company into confidence on what you are issuing. I think there is some logic if you look at it from a corporate ownership perspective. If we can think just a little bit more in terms of what the object of that disclosure is, we might probably find the answer.

Moderator: We have time for a few questions from the audience.

Q & A Session:

Q1. This is a very interesting topic. With reference to the tax side that Mr. Muthukumaran touched upon, what do you think will be the effect of the GAAR on future outbound M&A deals? Will it be the same, or is it going to change for the worse?

A1. First of all, I think the GAAR that was drafted leaves the decision completely to the discretion of the income tax officer. When it comes to outbound M&As,

in a DTC regime, we are going to have a Controlled Foreign Company Regulation (CFC). I don't think there is anything more beyond this that the GAAR will have an overbearing trouble in an acquisition with respect to M&A transactions and structuring. When it comes to on-going dealings between the Head Office and target offices in various countries, how the transfer pricing is going to be interpreted and what is going to be the reach of the GAAR are very uncertain. I think the best way of handling the GAAR is probably the tried and tested formula in various other countries, namely, the burden of proof of tax avoidance is on the income tax department.

Q2. My questions are to Professor Afra. How are the Indian laws compared to those in the rest of the emerging markets as far as outbound acquisitions are concerned, especially China? If I understood you correctly, you said that as far as financing is concerned, the demand for Indian paper outside is going to be lower given the current state of capital markets. Could you clarify that point further?

A2. I was saying that the demand for capital raising is low in general, and not necessarily just for Indian paper, given the decrease in the capital markets activity. Hopefully, the capital markets will pick up in the next few months, at least in the next year.

In terms of the comparison with other countries, I am not a specialist in all the other emerging economies; so I can't tell you all the specific details. It is very hard to compare the outbound M&A regime in China to India because the nature of the acquirers is very different. If you look at the data from Chinese companies, most of the acquisitions are done by government controlled entities. So the nature of the regulations of all those entities is very different because they are basically designing it themselves. However, if you compare India to Brazil, for instance, there are some relative similarities in terms of the restrictions on different kinds of outbound M&A transactions, and the ability to use different types of acquisition considerations, such as stocks. My hope is that eventually, India will get to a point where you are not emulating the regulatory requirements of other countries.

If you compare it to a country that has capital account controls, they are about the same; maybe a little better; but if you compare it with a country that does not have capital account controls, they are very restrictive. So I think capital account convertibility is the crux.

Thank you.

Notes

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