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Takeover code clashes with FDI caps, feels finmin

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New Delhi Within two months of the new takeover code being notified with its approval, the finance ministry has discovered that it is in potential conflict with the foreign direct investment (FDI) caps in sectors where foreign investment is capped at less than 51%. It has asked the Securities and Exchange Board of India (Sebi) to consider changes in the code to align it with the caps.

“The takeover code is in conflict with the FDI policy. We have asked Sebi to take a view on this at its next board meeting,” a senior finance ministry official requesting anonymity told FE. He refused to elaborate on actions required to resolve the issue, leaving it to the regulator to take a decision.

As per the code, any entity buying more than a 25% stake in a listed company has to make an open offer to buy an additional 26%. But where the acquirer is a foreign company, that would effectively mean a holding of 51% in a target company. This makes the foreign investment cap of less than 51% for sectors where there are listed companies irrelevant.

The conflict between these two policies was discovered by the finance ministry when called upon to give its comments on a department of industrial policy and promotion proposal to allow 26% FDI in civil aviation. Although in favour of the 26% cap, the finance ministry has told its commerce ministry counterpart that the takeover code needs to be tweaked to align with FDI policy.

A change in the takeover code will, however, be difficult for Sebi unless it is done for all listed companies. The current regime came in after a long series of negotiations with industry which had insisted that even the current code had raised the cost of acquisition for them.

Former Sebi member MS Sahoo said Section 32 of the Sebi Act says it’s “in addition” to other rules.

“The provision makes it clear that the Sebi rules (like the takeover code) will apply in addition to, instead of replacing current government regulations,” said Sahoo. According to him, if there was an FDI cap of less than 51% in a sector, the foreign company would not be allowed to make an open offer.

But that could be seen as an unfair distinction by minority shareholders in those companies. Jagannadham Thunuguntla of SMC Global said there was an inherent conflict between FDI policy which addresses the capital needs of the industry and the takeover code which addresses the minority shareholders interest. “The government will have to take a long-term view on all these sectors as making an exception to one or two will not solve the problem.”

Without the changes, the UPA government's reform agenda led primarily by opening up sectors like insurance, pension and aviation could hit a road block. Facing stiff opposition to foreign direct investment in multi-brand retail, the government is seeking to relax caps in other sectors like insurance to 49% from 26% through the Insurance Amendment bill. The Cabinet recently allowed 26% FDI in pension while it is also pushing for allowing foreign airlines to pick 26% stake in domestic carriers.

Preeti Malhotra, former president, Institute of Company Secretaries of India feels the solution lies in amending the takeover code. “The takeover code will have to be redefined to prescribe the sectoral cap in each of these sector if the new regulation has to work. In order to remain within the sectoral cap, the takeover code will have to spell out that open offer need to be made keeping in mind the sectoral cap,” she said.

The new regulations set the open offer threshold at 26% against 20% earlier. The rules will make listed companies get more investment from private equity firms and other investors to raise their stakes without hitting the threshold early. The larger open offer also ensures that both promoters and public shareholders get the same price for their shares from acquirers.