

Growth of Mergers & Acquisitions (M&A) In India in the Telecom Industry

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ABSTRACT

With more than 500 million subscribers, India is the second largest mobile phone market in the world after China. In the last decade, an average of 15 Telecom operators has started operations in India. The market has been flamboyant for Indian as well as Foreign investors. Many of them are entering through the Merger and Acquisition route. The Governing Regulatory Authorities have a responsibility that no irregularity occurs and that every investor is given equal opportunity. Spectrum which is a constrained essential input for mobile services is also highly fragmented leading to possible industry inefficiencies. This paper critically examines the Merger and Acquisition scenario in the Telecom industry in India and the current policy framework that provides policy prescriptions for the future.

Keywords: Telecom in India, Merger and Acquisitions, TRAI, DOT

There is an upward trend in the mergers and acquisitions in the Telecom Sector that are happening throughout the world. The aim behind such mergers is to attain competitive benefits in the telecommunications industry. Foreign investors and telecom majors look at India as one of the fastest growing telecom markets in the world. Sweeping reforms introduced & well supported by the Government over the last decade have dramatically changed the face of the telecommunication industry. The mobile sector has achieved a tele-density of 24% by July 2010 which has been aided by a bouquet of factors like aggressive foreign investment, regulatory support, competitive tariffs and falling network cost and handset prices. Both transnational and domestic telecommunications services providers are keen to try merger and acquisition options because this will help them in many ways. They can explore new markets, cut down on their expenses, achieve greater market share and accomplish market control.

1. INTRODUCTION

Currently, Merger & Acquisitions (M&As) have become very popular over the years especially during the last two decades owing to rapid changes that have taken place in the business environment. Meticulous pre-merger planning including conducting proper due diligence, committed and competent leadership, speed with which the integration plan is integrated all this pave for the success of M&As. The Telecom industry is one such field which offers ample opportunity for an M&A. India, as one of the fastest growing economies in the world has been on the forefront when it comes to M&A in the Telecom industry.

Table 1: Milestones in Telecom industry

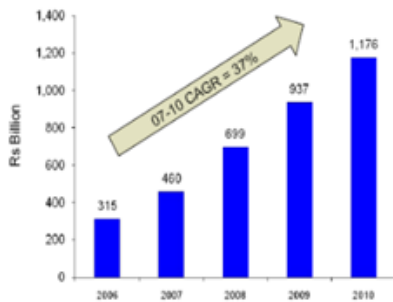
Pre-reform Pre-1994	Partial Deregulation 1994-1999	Further Deregulation 1999-2002	Take-off 2002 onwards
<ul style="list-style-type: none"> • MTNL - Mumbai and Delhi; DTS elsewhere • No mobile service • NLD - DoT per/ BSNL I.D. 	<ul style="list-style-type: none"> • 4 private fixed service providers with less than 1% market share • 2 GSM mobile players in each circle • 1st releases start 	<ul style="list-style-type: none"> • Licenses converted to revenue sharing • Private sector share less than 5% in revenue terms • Competition in NLD and ILD • Licenses on Revenue share 	<ul style="list-style-type: none"> • Calling Party Pays • CDMA launch • 3-6 operators in each circle • Intra-circle merger guidelines
<ul style="list-style-type: none"> • National Telecom Policy (NTP) 1994 • TRAI constituted 1997 	<ul style="list-style-type: none"> • NTP 1999 • BSNL formed 2001 • Internet Telephony 2002 	<ul style="list-style-type: none"> • Broadband policy 2004 	
National Telecom Policy, 1994	New Telecom Policy, 1999	Unified Licensing	

Source: IBEF

M&A have also been driven due to the deregulation of the industry & telecom firms

(telcos) providing bundled products and services, especially with the ongoing convergence of the telecom and cable industries. Telecom Reforms in India are indicated above (see Table 1)

Figure 1: Telecom Growth in India

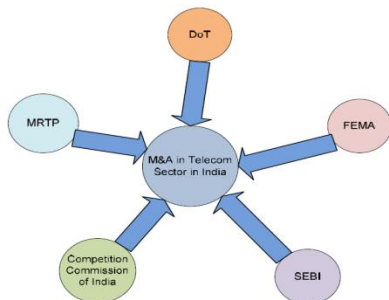


Source: Deloitte- M&A in India, 2011

2. REGULATORY FRAMEWORK

The mergers and acquisitions in the telecommunications sector are governed or supervised by the regulatory authority of the telecommunication industry of a particular country, for instance the Telecom Regulatory Authority of India or TRAI. The regulatory authorities always keep a tab on the telecommunications industry so that no monopoly is formed.

Figure 2: Regulatory bodies in India



Source: Author's representation

In India, M&A in telecom Industry are subject to various statutory guidelines and Industry specific

provisions e.g. Companies Act, 1956; Income Tax Act, 1961; Competition Act, 2002; MRTP Act; Indian Telegraph Act; FEMA Act; FEMA regulations; SEBI Takeover regulation; etc. We will cover some of these regulations hereunder which are unique to the telecom industry.

2.1 Telecom Regulatory Authority of India (TRAI) Recommendations

The Telecom Regulatory Authority of India (TRAI) was established on 20 February 1997 by an act of parliament called "Telecom Regulatory Authority of India Act 1997".

Telecom Regulatory Authority of India is of the view that while on one hand mergers encourage efficiencies of scope and scale and hence are desirable, care has to be taken that monopolies do not emerge as a consequence.

Recently, TRAI recommended that mobile phone companies could merge their operations if the combined market share of the new entity is less than 60%, a substantial increase over the current 40% ceiling. TRAI further proposed that in the case of M&As, there should be no spectrum caps and the combined entity be allowed to hold up to 25% of the total available airwaves in that region. TRAI had asked the government to impose revenue share on telecom tower companies and internet service providers at 3% if their annual revenues by 2012-13 and 6% by 2015-16. An 8% revenue share regime will increase the industry's outgo by several thousand crores annually.

2.2 Department Of Telecom (DoT) Guidelines

The Department of Telecommunication (DoT) has been formulating developmental policies for the accelerated growth of the telecommunication services.

Telecom department panel examining TRAI's recommendations has said that this could lead to a 'monopoly market situation' and has further suggested that the market share ceiling of the combined entity be reduced to 35%.

DoT can be credited with issuing a series of liberalizing initiatives in telecom sector which has led to phenomenal growth of the Industry.

It is noted that by providing higher limit of spectrum for merged entities, we may be

permitting something indirectly, which is not permitted directly and is against the principle of level playing field. Hence, it is desirable and appropriate to keep the prescribed limit as 10 MHz for Delhi-Mumbai and 8 MHz for other service areas in the M&A guidelines also. It has suggested that airwaves beyond this limit be surrendered within 12-month after a merger, and wants TRAI to specify penalties if additional airwaves are not returned.

Based on recommendations of TRAI, DoT issued guidelines on merger of licenses in February 2004. The important provisions are stated below:

- a) Prior permission has to be taken from the Department of Telecommunications for merger of the license.
- b) Under normal circumstances, the findings of the Department of Telecommunications would normally be given in a period of about four weeks from the date of submission of application.
- c) Merger of licenses shall necessarily be restricted to the same service area.
- d) Any merger, acquisition or restructuring, leading to a monopoly market situation in the given service area, shall not be permitted.
- e) Consequent upon the merger of licenses, the merged entity shall be entitled to the total amount of spectrum held by the merging entities
- f) In case the merged entity becomes a "Significant Market Power" (SMP) post merger, then the extant rules & regulations applicable to SMPs would also apply to the merged entity. TRAI has already classified SMP as an operator having market share greater or equal to 30% of the relevant market.

In addition to M&A guidelines, DoT has also issued guidelines on foreign equity participations and management control of telecom companies. The National Telecom Policy, 1994 (NTP 94) provided guidelines on foreign equity participation and as revised by NTP 99 permitted maximum 49% cap on foreign investment. Recently by its order no. - 842-585/2005-VAS/9 dated 1st February, 2006 DoT has enhanced the FDI limit in telecom sector to 74%. The key provisions of these guidelines are as follows:

- The total composite foreign holding including but not limited to investments by Foreign Institutional Investors (FIIs), Nonresident Indians (NRIs), Foreign Currency Convertible Bonds (FCCBs), American Depository Receipts (ADRs), Global Depository Receipts (GDRs), convertible preference shares, proportionate foreign investment in Indian promoters/investment companies including their holding companies, etc., referred as FDI, should not exceed 74%. The 74% investment can be made directly or indirectly in the operating company or through a holding company and the remaining 26 per cent will be owned by resident Indian citizens or an Indian Company (i.e. foreign direct investment does not exceed 49 percent and the management is with the Indian owners).
- The licensee will be required to disclose the status of such foreign holding and certify that the foreign investment is within the ceiling of 74% on a half yearly basis.
- The majority Directors on the Board including Chairman, Managing Director and Chief Executive Officer (CEO) shall be resident Indian citizens. The appointment to these positions from among resident Indian citizens shall be made in consultation with serious Indian investors.
- The merger of Indian companies may be permitted as long as competition is not compromised.
- The Licensee shall also ensure that any change in shareholding shall be subject all statutory requirements

2.3 Foreign Exchange Management Act (FEMA) Guidelines

Foreign Exchange Management Act, 1999 ("FEMA"):

FEMA and the various rules, regulations, circulars, etc. issued under FEMA consolidate the law relating to foreign exchange with the objective of facilitating external trade and payments and promoting the orderly development and maintenance of the foreign exchange market in India. The provisions of FEMA specify the

current and capital account transactions which may be carried on with general or specific permission of the RBI and/or the FIPB. The two most relevant regulations under FEMA from an M&A perspective are:

- I. Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 ("FDI Regulations"): The FDI Regulations and the press notes issued there under govern investments by persons resident outside India in shares, debentures (convertible and nonconvertible), security receipts and warrants of companies incorporated in India; in effect regulating inbound investments/acquisitions. In most sectors, 100% foreign direct investment is permitted (with or without conditions) without the prior approval of FIPB. In certain sectors it is permitted only to the extent prescribed, subject to conditions set out in the sectoral policy, without the prior approval of FIPB. Hostile takeovers on a cross border basis are effectively precluded.
- II. Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 ("Foreign Security Regulations"): Outbound investments by residents in India are regulated by the Foreign Security Regulations. Indian companies are permitted to invest up to 400% of their net worth in joint ventures or wholly owned subsidiaries abroad under the automatic route.

2.4 Securities & Exchange Board of India (SEBI)

Securities & Exchange Board of India (SEBI) regulations are applicable to listed group of Companies. For Telecom M & A the regulations are as follows-

Regulation 10- Acquisition of shares- Describes the substantial of shares for which public announcement is prerequisite. In this case acquisition by an acquirer to exercise 15% of voting rights require a public announcement

Regulation 11- Deals with the consolidation of holdings, primarily where an acquirer holds shares

less than 55% & wishes to acquire more. Secondly, where an acquirer acquired more than 55% but less than 75% requires a prior public announcement.

2.5 Competition Law

Competition Commission of India (CCI), established in 2003, holds the responsibility for ensuring free and fair competition in telecom sector. The Competition Act passed in 2002 & amended in 2007 provides control over M&A activity & abuse of dominant position in the market. Prior approval of CCI is required in M & A market in telecom sector.

CCI has extra territorial powers as regards to taking place outside India. The CCI can allow or disallow merger or can allow it with certain modification. Most of the operative provisions of Competition Act have still not been notified.

3. M&A IN TELECOM

Over the last few years, a phenomenal growth has been witnessed taking place in Telecom industry. Private sector investment & FDI have also boosted the growth of M&A in India. Following are the benefits provided in the Telecom industry

- Good Infrastructure
- Error free network
- Higher operating profit margin
- Acquisition of geographical territory
- Easier licensing options
- Access to products & services
- Combination of the above

3.1 Due Diligence- Areas Involved

Due Diligence is the most crucial part in M&A process- More important it gives acquirer in getting the price right. If issues are properly addressed, there will be no serious integration issues. Some of the Areas of Due Diligence are- Commercial Due Diligence- It examines the industry, current market share, competitors, per minute revenue, anticipatory regulatory changes in the licensed areas

Financial Due Diligence- Accounting of intangibles, Audited Financial Statements since inception

Legal Due Diligence- Examines the legal structure of business, contracts, potential regulatory issues

& impact on the business, MOM, Statutory clearances made till date, list of legal cases filed by & against the Company & the current status. Partner agreements, Dot license Agreements, VAS Services, liquidated damages, if any levied by licensor & list of all IPR Audits & IPR regulation issues.

HR Due Diligence- The investor analyses the ratio of outsourced employee to total employees, salary range vis a vis Industry trend and chances of salary increase to be made. The investor also tries to find out any premier benefits issued to senior management which has to be borne by the merged entity.

4. CASE STUDY – A THEMATIC VIEW

The first M&A deal in India was the sale of Mumbai license by Max group to Hutchison Whampoa group of Hong Kong. The deal fetched over half a billion dollars for Max group and was touted as a major success for Indian entrepreneur in telecom venture. This followed a series of M&A in subsequent years as stated hereunder. Some of the other high profile deals were Vodafone's acquisition of 10% equity in Bharti in 2006 for US\$ 1 billion, Maxis acquisition of Aircel at enterprise value of US\$ 1 Billion, Birla Group's acquisition of Tata's stake in Idea Cellular. Interestingly some of the high profile investors who had sold their stake around year 2000 are now reentering India like Telekom Malaysia (exited India in 2000 from Kolkata license and recently acquired 49% stake in Spice Telecom) and Vodafone (exited India in 2003 from RPG Cellular Chennai and recently acquired stake in Bharti). The author also closely followed the sell-off, acquisition, resale and reacquisition by Indian Promoters as a case study. In April 1998, Max group had sold its stake in Mumbai license to Hutchison Telecom for US\$ 560 million. Somewhere along the way Max group again picked up a small stake of 3.16% in Hutch and resold it to Essar Group in October 2005 for US\$ 147 million. Max India has staged another comeback in Hutch by acquiring an 8.33% from Kotak Mahindra Bank for Rs. 1,019 crore in 2006.

This second return to the telecom business reflects the buoyant conditions in telecom.

July 2011 issue of People Matters, 'M &A - The Indian Way' discussed how from an abysmally low level of deal volume and value in 2009, the following year, that is 2010, was a dramatic turnaround with deal activity at par with the levels of 2007. Bharti Airtel's acquisition of the African telecom company Zain for USD 10.7 billion was the most significant of the deals in terms of contributions to outbound M&A activity. The reasons for the renewed zeal and zest in the M&A arena, as experts argued could be attributed to a host of reasons including that of improved business confidence, ease of money sloshing around due to quantitative monetary easing by the Federal Reserve, low equity market valuations, the strengthening of the rupee against the dollar and most importantly the availability of assets that offered synergies with existing Indian businesses. The story categorically brought forth the point that the success of a deal depended not only on identifying the right targets, but it also required a good due diligence to evaluate both tangibles and intangibles and a planned approach for integrating culture, people and systems.

5. SWOT ANALYSIS

Below is an attempt made to Analyze the M&A in Telecom circles in India.

Strength-

- India, with its huge market base in Internet, Mobile, WiFi & WiMax offers ample opportunity & with regulations easing foreign entities tend to partner Indian companies & the growth story only seems to augment.
- Demand for new spectrum as the industry grows and the fact the spectrum allocation is done on the basis of number of subscribers will force companies to merge so as to claim large number of subscribers to gain more spectrum as a precursor to the launch of larger and expanded service

Weakness-

- Slow pace of the reform process

- It would be difficult to make in-roads into the semi-rural and rural areas because of the lack of infrastructure. The service providers have to incur a huge initial fixed cost to make inroads into Indian market. Achieving break-even under these circumstances may prove to be difficult

Opportunity-

- There is a significant number of tier 2 and tier 3 cities & that new M&A players can attract & accommodate more players here & one can expect aggressive response by the companies to such opportunities as and when they are created

Threat-

- The sector requires players with huge financial resources to sustain for initial period
- Upfront entry fees and bank guarantees represent a sizeable share of initial investments. While the criteria are important, it tends to support the existing big and older players. Financing these requirements require a little more liberal approach from the policy side.

6. CONCLUSION

Business firms now have to face increased competition not only from firms within the country but also from international business giants thanks to globalization, liberalization, technological changes, etc. In this paper, an attempt has been made to study the different regulatory bodies & their policies. Making the mergers work successfully is not that easy as here we are not only just putting the two organizations together but also integrating people of two organizations with different cultures, attitudes and mindsets. Critics claim telecom mergers reduce

competition and promote monopoly. In reality, Telecom mergers are part of a healthy competitive process and would foster innovation and bring benefits to consumers. The case study & SWOT analysis attempted justifies this point. Finally, the success of a merger hinges on how well the post-merged entity positions itself to achieve cost and profit efficiencies. As Robert C Higgins of University of Washington points out “careful valuation and disciplined negotiation are vital to successful acquisition, but in business as in life, it is sometimes more important to be lucky than smart.”

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