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# Vodafone Acquisition of Hutch-India: A Turbulent Wave in Indian Telecom Market

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***Abstract: This paper examines the outcome of selection of inorganic mode of expansion by Vodafone Group Plc. in its brown field investment of $18.2 billion in India. This work investigates the acquisition by Vodafone Group Plc. of Hutch-Essar from Hutchison Telecommunications. This paper is an original work of author and includes content of financial management, accounting and finance and would help in post graduate & doctoral studies.***

***Keywords: Acquisition, Vodafone-Hutch Deal, Merger wave.***

## I. INTRODUCTION

### *Mergers and Acquisitions: Financial and Economic Perception*

Today's era is completely different from the one that business world faced in earlier times. In past, the primary focus of the companies was to maximize their profit but now maximization of shareholders' wealth has become the main objective of the companies. Management must take decisions after thoroughly analyzing the impact of the decision on the company's share price and dividend that the shareholders would eventually receive.

Unlike steady but slow result oriented organic growth, M&A (an inorganic mode) have become easiest mode to achieve objectives of the firms. Adoption of inorganic mode facilitates CEOs and in turn management of the company to create value for their shareholders by resorting to those policies which enhances the share's market price through increased synergy and achievement of cost benefits. M&A are undertaken by companies to achieve strategic, tactical and financial objectives. It is undertaken to achieve the net economic advantage. M&A results in synergies or value addition from the firms' joint capacity to eliminate duplicate functions, exploit economies of scale, raise larger amounts of capital & share managerial expertise **(Ravens craft and Scherer, 1987).**

Corporations, worldwide, resorts to M&A to restructure, realign and reorganize their functionalities to equip themselves to face tough times ahead or to move ahead in time to kill competition. Apart from liquidity, dividend decisions, financing decisions, M&A are critical investment decisions a CEO makes for her firm. This path may include consolidation, amalgamation and absorption.

### *Background: M&A as Growth Strategy*

The merging of two companies into one is not a recent idea - there were 'waves' of corporate mergers back in the 1920s, the 1960s and the 1980s (**Fairburn and Kay 1989**). The Merger movement is predominantly a U.S. dominant phenomenon, which has witnessed merger waves.

 

***Merger Waves***

Mergers activities have been classified by various authors into so called waves by clustering activities during various periods. All of the merger movement occurred when the economy experienced sustained high rate of growth and coincided with particular development in business environments. Firms are not motivated to make large investment outlays when business prospects are not favorable. When favorable business prospects are joined with changes in competitive conditions directly motivating a new business strategy, M&A activities are stimulated resulting in formation of ***'mergers waves'***.

## II. LITERATURE REVIEW

Several researchers have tried to study the performances of acquiring firm post merger. The most popular forms of empirical studies are event studies, accounting studies, clinical studies and executive surveys. M&A activity's dramatic effects on the shareholders wealth raise the need for thorough assessment on the part of researchers and practitioners to check the validities of company's market value changes and to determine whether all market participants precisely foresee the long term effect of M&A on shareholders wealth. A study of 41 large acquisitions between 1979 and 1990 found a strikingly high correlation between the acquiring company's short-term stock returns and a present value measure of its first five years of post-acquisition operating performance (**M. Sirower and S. Francis**).

Surjit, 2002 carried out an analysis of 20 merging firms to compare the pre & post takeover performance by applying a set of eight financial ratios. He found that profitability and efficiency of merging companies declined in the post takeover period. Swaminathan (2002) studied the sample of five companies & found that four of the five acquiring firms improved operating and financial synergies (measured through financial ratios). Arora (2003) examined the post merger performance of merged companies using the value added metrics of corporate performance such as EVA, MVA and RONW.

The analysis conducted by means of analyzing the abnormal operating performance are divided into two groups; those using the earning based measures and those using cash flow based figures. Ravenscraft and Scherer (1987) used both approaches and concluded that when measuring the performance by use of accounting profitability a decline in wealth was detected whereas when the analysis was based on cash flow no decline was found which was also supported by Ghosh (2001).

Khemani (1991) states that there are multiple reasons, motives, economic forces and institutional factors that can be taken together or in isolation, which influence corporate decisions to engage in M&As. It can be assumed that these reasons and motivations have enhanced corporate profitability as the ultimate, long-term objective. Another study shows that merger did not lead to excess profits for the acquiring firm (Pawaskar, 2001). Mantravedi and Reddy (2008) investigate Indian acquiring firms and found that there are minor variations in terms of impact on operating performance following mergers in different sectors of Indian industries.

***Limitation of Above Studies***

The following are limitations of the various studied mentioned above

The studies have taken only mergers and leaving acquisitions in most cases. Absence of establishment of any standard for the measurement of post M&A operating performance further limits these studies.

With this back drop, here an attempt has been made in this paper to address some of the above issues not taken up in previously conducted work, which are as follows-

- The present work has studied acquisition of Hutch- Essar by Vodafone Group Plc.

## III. THE PAST AND PRESENT OF THE DEAL

**Vodafone's purchase of Hutchison Essar**

***Parties to the Deal-***

Mumbai based Hutchison Essar was India's fourth largest mobile operator with 16% market share. Other three were Bharti (22%), BSNL (20%) & Reliance Infocomm (18%). Hong Kong based Hutchison Whampoa, through its subsidiary Hutchison Telecommunications International, had joint venture with Essar in Hutchison Essar. After announcement of stake sale in Hutchison Essar by Hutchison Telecommunications International in 2006, UK based telecom giant ,Vodafone came into picture and picked up 67% stake in Hutchison Esssar for $11.1billion (Rs 48,752 crore) in February 2007. In the process, Vodafone edged out Essar Group, Anil Ambani's led Reliance Communications (RCom) and London based Hinduja Group. Indian acquisition fits into Vodafone's focus on the EMAPA markets (Eastern Europe, Middle East, Africa, Asia Pacific and affiliates markets).

With operations in over 25 countries, across five continents, 36 network partners and over 200 million customers base, Vodafone is considered as world's leading international mobile communication group. In 2006, Vodafone was world's largest telecom operator, with revenue to the tune of over $58 billion. After Hutchison Essar's acquisition its revenue rose to $64.3 billion ending March 2010 with net profit of $12.5 Bn. In 2009, Vodafone's net profit was $4.45Bn. Vodafone's earlier presence in India includes its venture after its merger with US based AirTouch. AirTouch had stakes in India's RPG Cellcom that had operations in Madhya Pradesh & Chennai. Vodafone had also picked up 10% in Bharti Televentures in 2005 for $1.5Bn (Rs 6,700 crore).

## IV. VODAFONE-ESSAR-CALL HISTORY

- 1992| Hutchison Whampoa and Max Group establish Hutchison Max
- 1995| Hutchison Max launches cellular services under brand name Max Touch
- 2000| Hutchison partners with Essar to launch Orange in Mumbai.
- 2003-06| Hutchison buys operations of AirCel Digilink, Essar Spacetel & BPL
- 2006| Orange named Hutch nationwide
- Dec'06| Hutchison plans to divest its 52% stake and sets floor price at $14Bn
- Jan '07| Due Diligence undertaken by prospective suitors.
- Feb '07| Vodafone emerges as top bidder for 67% stake for $11.1Bn.

**Vodafone-Essar – Call Drops**

- Sep'07| Income tax department of India sent $2.5Bn tax notice to Vodafone
- Sep '07| Vodafone seved show cause notice by I-T department
- Oct '07| Vodafone moves Bombay High Court against I-T notice
- Dec '08| High Court rules Vodafone's Hutch deal is taxable in India
- Jan '09| Supreme Court asks I-T to decide issue of jurisdiction
- Jan '09| Supreme Court allows Vodafone to move High Court
- May31 '10| I-T Depart claims jurisdiction to tax the transaction, issues orders
- Jun7 '10| Vodafone challenges the order in Bombay High Court

- Sep8 ‘10| High Court dismisses Vodafone plea, uphold IT department’s action
- Sep14 ‘10| Vodafone challenges Bombay High Court order in Supreme Court
- Oct ‘10| I-T department hands Vodafone $2.5bn tax bill.

The High Court upheld its earlier decision that I-T department had jurisdiction to tax the transaction. This has great significance as this is the first time an Indian court has ruled on whether an Indian tax authorities have jurisdiction over a transaction between two overseas corporate entities concerning a business venture in India. However, It allowed Vodafone to argue before Income Tax department against any penalty imposed for not deducting TDS (tax deducted at source). Experts believed that Bombay High Court decision against Vodafone would have major implications both for government and prospective mergers & acquisitions deals involving Indian companies. Another group of tax experts opined that the entire story of Vodafone –Hutchison deal to implement law with retrospective effect has cast serious doubts about stability of the implementation of Indian laws. It could effect FDI inflows due to perception of unpredicitable tax implications. Vodafone moved Supreme Court again. Supreme Court refused to stay Bombay High Court verdict and asks I-T department to compute exact tax liability of Vodafone on $11.1Bn acquisition within four weeks. Vodafone argued that very little was payable in terms of capital gains tax as the transaction was upstream transfer of shares from one company to another. Attorney General ,G.E. Vahanvati, appealed before Supreme Court that interest of I-T department must be protected in case Supreme Court was to stay HC order. He demanded deposition of part of the principle amount of Rs 8,500 due as capital gains tax, before Supreme Court in event HC judgement is stayed. The then chairman of Central Board of Direct Taxes (CBDT), S.S. N.Moorty, stated that the tax demand on Vodafone comprising tax, penalty and interest may go upto $2.6 Bn (Rs 12,000 crores).

**Vodafone-Essar – Unknown Calls**

In March 2011, Essar, the joint venturer of Vodafone in Vodafone-Essar, embarked on the reverse merger of Essar Telecommunications Holdings Private Limited (ETHPL) which has 11% stake in Vodafone-Essar with its listed group firm Indian Securities Ltd (ISL). Vodafone objected to the move as merger could distort the valuation of joint venture and the value of ISL could be misinterpreted as a fair market value of Vodafone–Essar. The objection by Vodafone has weight as Essar’s 33% holding in the Vodafone–Essar joint venture comes with a put option to sell entire stake or part of it to Vodafone for $5Bn and can be excercised by May, 8, 2011. Officially, dispute between the two partners began over valuation of Essar’s stake after Huctison Essar deal and bitterness in relations grew when Ruias of Essar took a fresh telecom licence through a Loop Telecom in 2008. Experts also believed that both Voda and Essar have conflicting management styles and this could be one reason that have aggreived the two parties. Vodafone’s global CEO Vittario Colao in an interview, however maintained that despite some differences, the company’s relation with their Indian joint venturer Essar has been successful. He also expressed his optimism and continued to be bullish about Indian telecom market despite the ongoing long running battle with Indian tax authorities. Despite these odds, in F.Y 2011-12 changes in FDI regime and revised definition of Indian company had helped Vodafone to maintain its holding within 74% without violating the FDI norms.

**Vodafone-Essar- Calling Truce**

In April 2011, Madras High Court, dismissing the objection of Vodafone, cleared the reverse merger of Essar Telecommunications Holdings Private Limited (ETHPL) with Indian Securities, a listed company controlled by the Ruias. By that time Ruias had already excercised their put option to offload their 33% stake in Vodafone for $5Bn that ended four year old joint venture between British telecom giant Vodafone Group Plc and the Indian conglomerate Essar group. The restructured deal amounts to $5.46Bn to Vodafone factoring in the potential $880 million tax liabilities. Vodafone will cough up $460 million while Essar will contribute $420 million toward the tax burden.The net payout to Essar stands at $4.58 billions. In July 2011, the two parties struck full and file separation pact.

**Vodafone – Chasing the Case**

- Jan20 '12| Supreme Court says no tax liability for Vodafone
- Jan20 '12| SC asked I-T depart. to return Rs 2,500 cr. to Voda with 4% interest.
- Jan20 '12| SC Registry returned Rs 8,500 cr. bank guarantee to Vodafone
- Jan21 '12| Vodafone share rose 1.4 percent on London Stock Exchange
- Feb17 '12| Government seeks review of tax verdict.

## V. THE OUTCOMES OF LEGAL TUSSELS

The Government of India, within a month of quashing the demand of I-T department for $2.6Bn capital gains tax on Vodafone, moved the apex court to seek total recall of its verdict and lists 121 grounds to term the judgment erroneous and contradictory. In a 100 page review petition filed by the Centre and I-T department, the government expressed its surprise on court's decision to consider the Vodafone Hutchison deal as structured FDI investment in the country. The petition challenged the relief given to Vodafone and the review is sought by the government on the ground that the court failed to consider the arguments advanced on its behalf by the solicitor general and also failed to appreciate the consequences of its judgement on the steps taken by the government of India to promote tax transparency and fight tax evasion. Government in its review petition faulted the lengthy judgement and stated that not a single penny came as investment into India and sale consideration was admittedly paid outside India so quashing the capital gains tax demand of I-T department and considering the transaction as bona fide structured FDI investment into India, the judgement, on the face of records, suffers from errors.

-Mar 7 '12| Finance Minister refuses to hang up on Vodafone case

Government proposed to change tax laws retrospectively to taxes transactions such as Vodafone-Hutchison deal involving foreign players with interest in Indian companies to vet approximately Rs 40,000 for government exchequer. This move of government set to impact others also like Tatas and AV Birla group which had entered into similar transaction in the past ( purchase of AT&T stake now known as Idea). The Finance Bill by then finance minister Mr. Pranab Mukerjee has proposed to amend the tax laws w.e.f. April 1962. The bill proposed to make company liable to pay capital gains tax to the government even if the companies are registered overseas and deal is done offshore. Tax experts viewed the government move to amend tax laws as a long drawn process and has collectively opined that the move would surely, severely & adversely impact foreign investment in the country.

**Vodafone – Making Another Call-*dailing again***

-Mar 22 '12| Government readies fresh salvo & plans to issue fresh notice

After Supreme Court's rejection of the review petition filed by the government, the finance ministry & tax department plan to issue fresh tax demand notice to Vodafone and awaits only passage of Finance Bill. Government also plans to make Vodafone a representative assessee as tax department and ministry are unable to press such demand on Hutch that sold the stake to Vodafone. The government and its department are relying heavily on Clause 113 of the Finance Bill in addition to amendments to Section 9# of the Income Tax Act. The government considered this a long drawn affair & geared for it.

The Voda case saga refuses to end. Vodafone considering launching International arbitration proceeding against Indian governement under India –Netherlands Bilateral Investment Treaty (BIT) signed in 1995 and served 'notice of dispute' against the Indian Government that demanded abandoning or suitably amending the retrospective aspects of the proposed legislation .

Experts believed that Vodafone might invoke 'unjust expropriation' clause in the treaty against the Indian Government. Vodafone believed that proposed retrospective legislation amounted to denial of justice and breach on the part of Indian government, against the investment treaty, to provide fair and equitable environment for investment in the country.

-Jun '12| Government of India indicates to move slow on Voda tax case

-Oct '12| Committee submitted its report on retrospective tax to government.

After taking over the rein in North Block, the Prime Minister Dr Manmohan Singh and his new team decided to go slow on raising any fresh tax demand on Vodafone.

The move came after receiving blistering criticism from all governments of the world and scared foreign investors. Prime Minister Dr Manmoham Sigh, the architect of the country's economic reforms in 1991, sought clarifications on taxation issues including the retrospective amendements from the tax department.

## VI. The Battle Continues and Its Impact

A committee in this regard was constituted by the Prime Minister which submitted its report on retrospective tax amendments and recommendentation on October 2012.Since then there is no amendements and clarification as regards this provision.

One significant aspect, till date, about the Vodafone tax case that does send positive signals to the global investors is the landmark judgement of Supreme Court that upheld that foundation of any fiscal system is certainity and stability. The judgement, on one hand, boosts foreign investors confidence in the Indian judiciary and settled the long pending dispute on the other. To this long drawn dispute, the latest addition is the Rs 3,700 crores tax demand on Vodafone in regards to transfer pricing dispute with tax department. This latest development made unclear in which direction this dispute is likely to move.

-Oct '14| Vodafone wins transfer pricing case as well agiantst tax department

The government decided not to move apex court against Bombay High Court order on transfer pricing tax demand to propogate fair & transparent tax regime under new government. It seems government will look at conciliation route to solve such dispute as indirect transfer dispute (Vodafone- Hutch Essar deal) to send clear message to foreign investors to promote and encourage foreign investment in India. Till October 2015,Vodafone was engaged in an ongoing international arbitration on the indirect transfer tax dispute with India under the bilateral investment treaty. In Feburary 2016 , I-T department again slapped Rs. 14,000 crore tax notice on Vodafone and term it as routine procedure. Vodafone expressed discontentment over the issue of notice and demanded resolution the dispute through current judicial process. Government wants, on the other hand, amicable settlement of dispute and hinted at letting go Vodafone on penalty and interest on deposition of capital gains tax in the exchequer.

## VII. Finding

The high premium involved in the deal and budding stage of Indian telecom industry, at the time of the investment, with low average usage per person resulted in the negative operating performance for Vodafone India viz Vodafone Group Plc. Operating performance improved in following years as seen in improvement in EVA but was not sustainable. Furthermore, factors like 2G scam, cancellation of spectrum allocations in telecom circles and stiff competition from players like Bharti Airtel and others in highly competitive Indian telecom market required further capital infusion by Vodafone which mars future growth prospects. With gradual decreasing revenues per person and tax dispute matters cause a decline in its overall operating performance.

## VIII. CONCLUSION

The study has concluded that M&A indeed has effect on the operating performances of the entities involved. One significant aspect that emerges while analyzing Vodafone-Hutch Essar deal was that macro economic variables has played a significant contribution to the operational aspect of company post merger and acquisitions. Case studies of this deal with the window period of five years post M&A pointed out struggle for striving for balance against macro variable threat by the combined entity post M&A for sustainable growth. In Vodafone-Hutch Essar deal legal and tax issues worked as detterent to achieve success. In present scenario Vodafone India is contemplating mergers with other Indian telecom giants for the company's sustainablity and growth.

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