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## **LEVERAGED BUYOUTS IN INDIA: REGULATORY BARRIERS AND CORPORATE RESTRUCTURING**

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### **ABSTRACT**

Leveraged Buyouts (LBOs) are widely recognised as successful restructuring technique. These transactions include acquiring a target firm primarily through debt financing secured against its assets and cash flows. However, a number of regulatory obstacles severely restrict domestic LBO activity in India. Under the right regulations, LBOs can increase productivity and boost shareholder value in India's corporate world. However, their success depends on striking a careful balance between strict debt management and protecting minority shareholders. The paper explains what are LBOs and the case study of Tata Tea's acquisition of Tetley one of the biggest cross border acquisitions. The paper also delves into how LBOs are effective for corporate restructuring. The Indian regulatory environment, which prohibits leveraged finance for domestic acquisitions, is then critically examined. This includes a careful examination of guidelines and circulars issued by the RBI from time to time along with FIPB Press Note 9 (1999), and Section 67(2) of the Companies Act, 2013. The paper also demonstrates how domestic corporations have so far chosen offshore targets in order to get around these stringent restrictions. The paper concludes with recommendations and calls for changes in regulations, like reviewing Section 67(2) of the Act. Amendment in the said section along with growing the domestic corporate debt market, will enable India to fully tap the potential of LBOs.

## I. Introduction—Understanding LBOs

Companies tend to employ corporate restructuring as a strategic method to address poor performance and increase capital market credibility. It can also have a huge impact on a company's market value.<sup>1</sup> A powerful financial restructuring tool exists which is the form of leveraged buyout (LBO). The central idea of an LBO is its ability to require minimal start-up capital since it obtains financing through the target company assets and projected cash as the leverage for borrowing. The funding comprises debt and equity in a 70:30 proportion which maintains low capital costs because debt costs less than equity.<sup>2</sup>

The financial restructuring is achieved through the “leverage effect”, since utilizing borrowed money amplifies possibilities of making profit. The acquisition process requires acquirers and private equity investors along with target management personnel to invest those funds into a special purpose vehicle (SPV), which is specially established for the purposes of acquisition as the name rightly suggests. The borrowed funds are meant as a temporary solution as the company implements restructuring initiatives. The next phase of corporate restructuring requires the company to eliminate the non-core assets, reduce costs and achieve operational efficiency which will generate enough cash flow to repay the acquired debt.<sup>3</sup>

A “buyout” means acquiring the majority equity control alongside converting a company from public to private. Private ownership after a LBO enables the organizations to perform aggressive corporate restructuring because they face less market-based time constraints and volatility.<sup>4</sup> The company post-LBO moves towards improving profitability combined with operation streamlining and debt reduction until it can be reinstituted publicly through an IPO or otherwise.<sup>5</sup> This restructuring method demonstrates effectiveness based on actual research findings. Using a metric known as Shareholders' Value Added (SVA), a study conducted by Dr. Suman Patra distinguished businesses that underwent LBOs with similar enterprises that did not. The findings demonstrated that there was a statistically significant increase in SVA for

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<sup>1</sup> Santhosh Kumar A.V and Dinesh N, ‘Corporate Restructuring in India with Special Reference to Reliance Industries Limited (RIL)’ (2013) Volume 2 ParipeX - Indian Journal Of Research <[https://www.worldwidejournals.com/paripex/article/corporate-restructuring-in-india-with-special-reference-to-reliance-industries-limited-ril/MzI0NTg=/](https://www.worldwidejournals.com/paripex/article/corporate-restructuring-in-india-with-special-reference-to-reliance-industries-limited-ril/MzI0NTg=/>)> accessed 19 March 2025.

<sup>2</sup> Soham Banerjee and Nikhil Suresh, ‘Leveraged Buy Out- Law and Practice in India’ (*Hein Online*2014).

<sup>3</sup> Narendra Chokshi, ‘Challenges Faced in Executing Leveraged Buyouts in India the Evolution of the Growth Buyout’ (NYU Stern 2007) <[https://www.stern.nyu.edu/sites/default/files/assets/documents/uat\\_024317.pdf](https://www.stern.nyu.edu/sites/default/files/assets/documents/uat_024317.pdf)> accessed 19 March 2025.

<sup>4</sup> *Ibid.*

<sup>5</sup> *Ibid.*

companies that participated in LBOs. This result lends credibility to the claim that LBOs actually boost shareholder value.<sup>6</sup> Moreover, Rajiv Memani, CEO, Ernst & Young India says, “LBO is a good option for companies with strong cash flows and low-debt levels on their books.”<sup>7</sup>

However, one of the main constraints to a LBO success in India is due to bank-centric financial structure combined with stringent regulations on lending. It may be argued that companies can look into other sources for funding, however this argument will not stand since the non-banking institutions are not developed enough to fund big LBOs in India and banks continues to be the primary source of capital.<sup>8</sup> The reason why Indian companies are unable to carry out LBOs in the domestic market and are instead driven towards acquiring offshore companies will be discussed in this paper. Tata Tea’s LBO of Tetley functions as an exemplary case of a cross-border LBO which allowed a domestic company to become a global branded enterprise<sup>9</sup> and also demonstrates how LBOs can be successful for value enhancement, this will be the central case study which will be discussed ahead in the paper.

## II. Barriers to LBO’s in India

### A. The Companies Act, 2013

Section 67 (2) of the Companies Act 2013<sup>10</sup> plays a critical role in restricting domestic LBO’s, even though it wasn’t drafted with that intention. The said section prohibits giving of Loan/Financial Assistance Prohibited and “disallows a public company and a private subsidiary of a public company to give loan or provide financial assistance (directly or indirectly) to any person to enable him to purchase or subscribe company's own shares or shares of its holding company.”<sup>11</sup> This section makes it virtually impossible to obtain security of assets

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<sup>6</sup> Suman Patra, ‘IMPACT of LEVERAGED BUYOUT on SHAREHOLDERS’ VALUE ADDED: EVIDENCE from SELECT INDIAN COMPANIES’ (Business Spectrum 2020)

<[http://admin.iaasouthbengalbranch.org/journal/23\\_Article1.pdf](http://admin.iaasouthbengalbranch.org/journal/23_Article1.pdf)> accessed 19 March 2025.

<sup>7</sup> Amanpreet Singh, ‘Leveraged Buys Gain Momentum’ (*The Economic Times* 12 October 2006)

<<https://economictimes.indiatimes.com/news/economy/finance/leveraged-buys-gain-momentum/articleshow/2162230.cms?from=mdr>> accessed 19 March 2025.

<sup>8</sup> Hrithik Merchant, ‘How LBOs Can Be the Answer to India’s NPA Crisis’ (*IRCC* 11 October 2022)

<<https://www.ircl.in/post/how-lbos-can-be-the-answer-to-india-s-npa-crisis>> accessed 19 March 2025.

<sup>9</sup> LJ Bourgeois and Rasjan Dutt, ‘Tata Tea Ltd. And Tetley, Plc (A)’ (*papers.ssrn.com* 21 October 2008)

<[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=907952](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=907952)>. accessed 19 March 2025.

<sup>10</sup> The Companies Act, 2013, s.67(2).

<sup>11</sup> Dr GK Kapoor and Dr. Sanjay Dhamija, *Taxmann’s Company Law – Updated | Amended | Authoritative Book Blending Statutory Provisions | Judicial Interpretations | Real-World Insights to Simplify Complex Legal Concepts [2025]* (Taxmann Publications Private Limited 2019).

for a publicly listed company until it delists itself and converts itself into a private company.<sup>12</sup> The section was initially aimed to restrict buy back of shares, with the object to curb "trafficking" of a company's own shares.<sup>13</sup> However, it prevents essential corporate restructuring activities because it blocks firms from using stock and cash flow as debt financing assets. This limitation causes severe damage to domestic LBO's since LBOs use modest equity and substantial debt. Section 67(2) of the act obstructs leverage-based investment activity because it requires total equity funding and fails to grasp leverage as a foundational for a LBO. It raises capital requirements and deterring investment opportunities. This section displays inflexibility as it disregards the possibility of supervised LBO activities without share value manipulation despite LBO's being a great tool for financial restructuring. An amendment in this section is necessary, this could be done by careful implementation of formulated exceptions for genuine LBOs with rigorous compliance protocols.

## B. FIPB PRESS NOTE 9

Historically, FIPB Press Note 9 (1999) prohibited Indian banks from lending to foreign investors solely for the purpose of acquiring shares in Indian companies. The objective was to maintain stability in domestic capital markets and limit speculative foreign leveraged acquisitions. However, this restriction was **repealed by Press Note 4 of 2009**, which removed the prohibition, and since then, **no directly analogous restriction appears to have been reintroduced**.<sup>14</sup> This is basically done to maintain stability in the domestic capital markets. In India, LBOs are carried out by private players. Private equity firms look to acquire companies with financial difficulties and then use corporate restructuring, or simple remodelling, to boost profitability, settle debts, and then remove themselves from the company through an exit plan. In the absence of updated rules replacing the repealed Press Note 9, investors and acquirers must navigate a grey area, particularly with respect to external commercial borrowings (ECBs), downstream investment restrictions, and the permissibility of using Indian bank funds in acquisition structures. Thus, while Press Note 9 (1999) no longer has legal force, its historical influence, and the regulatory vacuum left in its wake, continue to cast uncertainty over foreign-funded LBOs in India.<sup>15</sup>

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<sup>12</sup> *Ibid.*

<sup>13</sup> *Ibid.*

<sup>14</sup> Foreign Investment Promotion Board Review and others, "FIPB - Review 2009" (2009)

<<https://fipb.gov.in/Forms/FIPBVIEW2009.pdf>> accessed 19 March 2025.

<sup>15</sup> *Ibid.*

### C. RBI's Restrictions

Leveraged financing in share acquisitions has always seen a strict regulatory approach from the RBI which has prevented the growth of LBOs in the country. RBI has imposed these limitations for banking stability purposes, which has unintentionally created disparities that benefit global businesses more than they benefit domestic corporations. The core RBI policy stands as a ban which bars domestic banks from issuing loans for purchasing shares in a domestic company. The regulatory requirement forces promoters to use their personal assets instead of borrowing from banks to fund equity investments. This in turn creates substantial capital constraints. Protecting banks from exposure form the basis for this policy restriction.<sup>16</sup>RBI's Master Circular on Loan and Advances of July 2015 permits collateral for secured loans only for 'working capital' or 'other productive purposes'.<sup>17</sup>

These restrictions fails to fundamentally support LBOs since LBO transactions require debt-based capital for acquisitions supported by the acquired firm's property and predicted cash stream, which are at the core of carrying out a LBO. This restrictive stance of RBI keeps Indian companies from pursuing strategic acquisitions and subjects them to alternative financing structures that carry heavy costs.

Since 2005, the RBI has established permission for Indian banks to provide financing to domestic firms for pursuing investments in both joint ventures and wholly owned subsidiaries by international firms.<sup>18</sup> This policy inconsistency becomes problematic because restrictions do not apply to financing acquisitions outside India while they exist for domestic ones. The RBI maintains opposite regulations which permit Indian companies to use leverage for international expansion yet restricts them from doing the same for home-market restructuring. This reflects RBI's bipolar view of LBOs. Because of these RBI prohibitions some buyers are now forced to seek financial backing from Non-Banking financial companies (NBFCs) which provide higher borrowing costs and stricter loan terms as compared to banks.<sup>19</sup> The regulatory gap between banking institutions and NBFCs boosts capital expenses for Indian businesses and

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<sup>16</sup> Soham Banerjee and Nikhil Suresh, 'Leveraged Buy Out- Law and Practice in India' (*Hein Online*2014).

<sup>17</sup> "Reserve Bank of India" <<https://www.rbi.org.in/commonman/english/scripts/Notification.aspx?Id=1449>> accessed 19 March 2025.

<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid.*

reduces their potential for large-scale financing since NBFCs operate with less funding power than banks.

Financial Restructuring and operational turnaround remain out of reach due to the absence of leveraged financing in Indian domestic M&A transactions which hamper value creation. A better approach than a total ban on leveraged financing should establish protection mechanisms to enable properly structured acquisitions under controlled leverage circumstances. In absence of reforms in regulations, will lead to restricted growth in a highly competitive global market.

#### **D. RBI's discussion paper**

In 2013, due to economic slowdown in the country, the RBI felt that there was a need to explore the possibility of expanding the scope of LBO's in the country to help companies in financial restructuring, which would in turn help in value creation. Even though the proposals made in the discussion paper released by the RBI were not implemented, it is pertinent to analyse the paper in this context. In the current regulatory framework LBOs are only partially allowed, in the sense that they are only permitted for companies which can be classified as SMEs and banks are disallowed from extending a line of credit to companies which are looking for an acquisition using the target company's assets.<sup>20</sup>

The discussion paper suggested "*rectification, restructuring and recovery*".<sup>21</sup> The paper seeks to make a shift in bank's lending by allowing them to give credit to special entities, for example private equity funds under stringent guidelines. This would essentially allow such private equity funds to acquire distressed firms. This proposal would also require them to form a Special Purpose Vehicle (SPV) or something similar. The intention behind this requirement is essentially to isolate the debt from the parent company's balance sheet and minimise the risk of bank's exposure.<sup>22</sup>

If this proposal were to be adopted, it could bring positive changes in the current corporate restructuring framework of India. The proposed changed would remove some hurdles on debt financing for such acquisitions. This would also create a new space for domestic value creation

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<sup>20</sup> *Ibid.*

<sup>21</sup> Reserve Bank of India, 'Discussion Paper on Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalising Distressed Assets in the Economy' (17 December 2013).

<sup>22</sup> *Ibid.*

and efficiency in the market. In light of RBI's discussion paper on LBO's, it is of utmost importance to build effective regulations to safeguard banks by ensuring that the borrowing entity can generate enough cash flow to repay the debt.

### III. Case Study- Tata Tea- Tetley LBO

It is now imperative for us to look at examples of LBOs which involve domestic companies. Even though there have been negligible LBO's where a domestic company was acquired due to regulatory barriers, we can see a couple of examples of cross-border LBOs where domestic companies have acquired off shore companies. Tata Tea's acquisition of Tetley is going to be the central example which will be discussed in great detail below, other examples include Tata Steel's acquisition of CORUS<sup>23</sup> and UB Group's acquisition of Whyte and Mackay.<sup>24</sup>

One of the largest cross border acquisition by an Indian company through an LBO was carried out by Tata Tea in the year 2000 by acquiring a UK-based company for £271 million. Tetley's net worth at that time was \$114 million.<sup>25</sup> Andrea Goldstein stated that Tata Tea created a landmark moment in Indian companies taking over the global market. The transaction provided minimal capital expenditure to Tata Tea by leveraging Tetley's assets and future cash flows in order to obtain financing.<sup>26</sup> A SPV named Tata Tea Great Britain was formed which isolated the debt from Tata Tea's balance sheet. Through this financing structure Tata Tea managed to shift from being a primarily local low-margin tea company into a global company while keeping substantial financial risk away from the core organization.<sup>27</sup>

The intention behind carrying out this LBO was corporate restructuring, sharing resources, changing global trends in the tea market along with making Tata Tea a global player in the tea market. Tata Tea conducted most of its business before acquisition as a commodity seller with minimal consumer interaction. Tetley had a strong brand value and extensive international

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<sup>23</sup> TNN, 'Corus Buy: Tatas May Go for Leveraged Buyout' (*The Economic Times* 10 October 2006) <<https://economictimes.indiatimes.com/industry/indl-goods/svs/steel/corus-buy-tatas-may-go-for-leveraged-buyout/articleshow/2143113.cms?from=mdr>> accessed 19 March 2025.

<sup>24</sup> Sameera Anand, 'United Breweries Group Acquires Whyte & Mackay' (*FinanceAsia* 17 May 2007) <<https://www.financeasia.com/article/united-breweries-group-acquires-whyte-mackay/81218>> accessed 19 March 2025.

<sup>25</sup> Oishika Banerji, 'A Cross Border Acquisition You Must Know About- Tata Tea Acquired Tetley Tea' (*iPleaders* 27 July 2021) <<https://blog.ipleaders.in/cross-border-acquisition-must-know-tata-tea-acquired-tetley-tea/>> accessed 19 March 2025.

<sup>26</sup> Andrea Goldstein, 'Tata and Total: Managing Cross-Border Acquisitions in India and France' (Nomura Foundation, 2007) [https://www.nomurafoundation.or.jp/en/wordpress/wp-content/uploads/2014/09/20071113-14\\_Andrea\\_Goldstein.pdf](https://www.nomurafoundation.or.jp/en/wordpress/wp-content/uploads/2014/09/20071113-14_Andrea_Goldstein.pdf) accessed 20 March 2025.

<sup>27</sup> *Ibid.*

distribution capabilities which enabled Tata Tea to switch from being just a commodity seller into a premium consumer-focused company.<sup>28</sup> Operational efficiency became the main priority for Tata Tea under the LBO structure because it needed to maintain sufficient margins to repay its debt. LBOs create a “discipline effect” where high leverage demands operational assessments in all aspects.<sup>29</sup>

The practical implementation of this acquisition required Tata Tea to simultaneously push forward aggressive corporate restructuring while also maintaining the Tetley brand elements which put cross-border governance structures to test.<sup>30</sup> The successful outcome of the Tata Tea-Tetley acquisition occurred because it engaged a foreign target company and could bypass the restrictions laid down by the RBI. This also showcased the unfulfilled potential for restructuring domestic companies. Indian private equity funds face limitations from current regulations from using bank debts to acquire domestic companies through equivalent leveraged buyouts of domestic companies. This case study proves how financial engineering through a LBO can enable the development of domestic companies into international giants when the regulatory environment is supportive of such acquisitions.<sup>31</sup>

#### IV. Conclusion

Conclusively, companies can rectify subpar performance, seek out new strategic prospects, and gain credibility in the capital market with the aid of corporate/financial restructuring. Financial restructuring of companies by way of leveraged buyouts may drastically impact a company's market value, possibly by billions of dollars, with the promise of considerable shareholder value creation. Tetley's acquisition by Tata Tea provides evidence of the effectiveness of LBOs when carried out in a regulatory climate that is supportive of them. However, domestic LBO activity is virtually non-existent due to India's current legal framework, which is defined by the FIPB restrictions, RBI directives, and statutory prohibitions under the Companies Act, 2013 as argued in the paper. Due to these limitations, investors are compelled to pursue cross-border deals, missing out on potential to improve the performance and restructure Indian companies. It is necessary to reevaluate regulatory regulations if LBOs are to act as engines of growth in our country. The ultimate key to maximizing the benefits of LBO-driven corporate

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<sup>28</sup> *Ibid.*

<sup>29</sup> Yael Eishental-Berkovitz, Peter Feldhütter and Vikrant Vig, ‘Leveraged Buyouts and Bond Credit Spreads’ (2020) 135 *Journal of Financial Economics* 577.

<sup>30</sup> *Ibid.*

<sup>31</sup> *Ibid.*

restructuring will be striking a balance between the necessity of debt discipline, protections for minority shareholders, and an active corporate debt market. India is a fast growing economy with immense untapped potential, where many companies have significant operational potential and revenue streams focused on exports. Lowering regulatory barriers as suggested in RBI's discussion paper and making necessary amendments in Section 67(2) of the Companies Act, 2013 would bring India's regulatory environment closer to international best practices.