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Acquisitions through Emerging Market Corporations inside Created Markets

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Abstract – This paper examines the results of merger and acquisition (M&A) activities of Indian corporates. The key issue is the extent to which these M&As create value for the shareholders of the Indian acquiring firms. There are two components to this question relating to the short and longer term impacts. First, how does the market react to the announcements related M&As by Indian corporates in the short term? And second, how successful are the Indian companies in creating value to the shareholder in the long run? The research further considers the firm specific level using a sample of M&A companies and how media material may have contributed to the market impacts experienced by the corporates. The purpose of this paper is to answer whether a Developed Country firm would generate higher returns to its shareholders by acquiring a company from the India or by acquiring an Emerging Market target. It includes an extensive literature review that covers the main motives and theories behind M&As. Also, the cross border M&A theory and the rationale behind the internationalization and location decisions are discussed. Furthermore, an analysis of empirical studies in Indian Domestic M&A, cross border M&A and M&A in Emerging Markets is presented. Emerging markets have become important investment destination for international investors as they seek opportunities to grow and diversify their investment portfolios. At the same time, emerging markets are perceived to be riskier than developed markets. It is therefore imperative for the international investor to fully comprehend and appreciate the risk faced by their investments in the emerging markets and the drivers of the underlying their value.

Keywords: Acquisitions, Emerging, Market, Corporations, Indian Corporates, Companies, Important, Investor, etc.

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INTRODUCTION

The “India story” has seen a profound shift in gear and direction during 2006. While in recent years most media references to India’s growth have focused on the sub-continent as a destination for outsourcing and investment, this year has seen the arrival of India as a shaping force evident in the powerful new trend towards overseas acquisitions by Indian companies. Indian mergers and acquisitions (M&A) is the search for top-line revenue growth through new capabilities and assets, product diversification and market entry. This trend is not driven purely by opportunistic factors: Indian companies are in many cases motivated to look abroad in response to newly competitive, complex or risky domestic markets or to find capabilities and assets that are lacking in India. The steep increase in the number of major cross-border transactions in recent years - from 40 in 2002 to more than 170 in 2006 - has been facilitated by the relaxation of regulations on overseas capital movements as well as a more supportive political and economic environment, including deeper currency reserves, and easier access to debt financing, both at home and from international banks. This M&A trend is a key factor helping Indian companies to emerge on the global stage. Six Indian companies feature in the Fortune Global 500 list of the biggest companies in the world. These are Indian Oil, Reliance Industries, Bharat Petroleum, Hindustan Petroleum, Oil & Natural Gas, and the State Bank of India. Based on current growth and M&A trends, we would expect this number to double by 2010. The strategy by which many Indian companies are expanding globally is also distinctive. As Indian companies are relatively small by the standards of global multinationals, their cross-border acquisitions also tend to be smaller. These deals are therefore often carried out as part of a broader globalisation drive involving a string of strategically targeted acquisitions. This is particularly the case for India’s larger corporate groups, for example Tata’s that look to strengthen specific parts of their value chain and develop globally integrated offerings. The locations of the acquisitions also reflect the strategies of India’s globalizers. Attracted by the markets and higher value offerings of developed economies, Indian companies are making the vast majority of their transactions in North America, Europe and the more developed economies in Asia, with transactions equally distributed between these locations.

REVIEW OF LITERATURE:

A new class of business leaders fuels India's current success in overseas acquisitions. The confidence within the Indian business community, combined with its natural entrepreneurial zeal and intuitive ease with global business models, creates a formidable force. India's economic Liberalisation in 1991sparked fears that the country would be overrun by foreign multinationals. However, Indian companies have not only managed to fight off competitors on their home ground, they also have taken the commercial battle abroad. Moreover, India's M&A activity is anticipated to accelerate dramatically in the immediate future. A recent Grant Thornton study found that 94 percent of Indian companies that expect to do a deal in the next three years expect it to involve foreign acquisitions. As Indian companies mature, overseas acquisitions offer the most tangible evidence yet of their new found readiness to compete on the global stage. This study sees India as an example of an emerging market. It aims to provide an understanding of how the extant literature on M&A stands when applied in the context of emerging-market firms making acquisitions in developed markets. One major issue is to understand the extent to which the character of an emerging market needs to be factored in when conventional corporate wisdom in M&A is applied to acquisitions made by emerging market firms in developed markets.

Cross Border Acquisitions by Firms in Emerging Markets: Emerging market firms have become strong contenders in the Cross Border Acquisition Market. Initially they were targets for acquisitions by developed country acquirers. In the last decade, they have turned acquirers, expanding their presence in the global scenario by acquiring firms from both emerging and developed markets. "The hunters are fast becoming the hunted in the race for cross-border transactions between emerging and developed markets" (KPMG Emerging markets international acquisition tracker). AT Kearney researchers (2008) found that there has been a fundamental shift in the Merger and Acquisition world since 2002, with companies from developing countries such as India, China, Malaysia, the United Arab Emirates, Russia and South Africa snapping up established companies at an astonishing rate, with India spearheading the acquisition market. Thomson Reuters (2011) in their investment banking review for 2010 announced that emerging markets accounted for 33% of the USD 2.4 trillion in cross border acquisitions for the year.

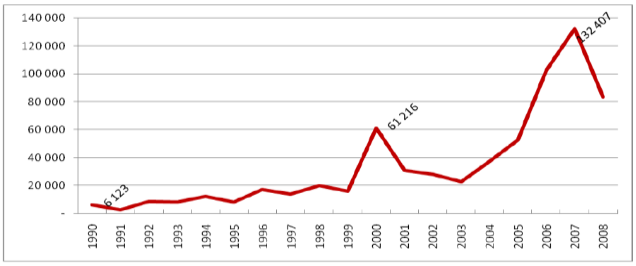

Figure 1: Cross Border Acquisitions by emerging Market Firms in US Dollars (Computed from UNCTAD cross-border M&A database WIR2009).

Cross border acquisitions by Indian companies increased from USD 23 million in 1990 to USD 29 billion in 2007. (UNCTAD cross-border M&A database). The financial crisis in 2008 led to a decline in volume in 2008 and 2009. As per a report by E&Y (2011); cross border acquisitions by Indian firms recovered in 2010, at USD 32 billion, above the earlier highest value of USD 29 billion in 2007.

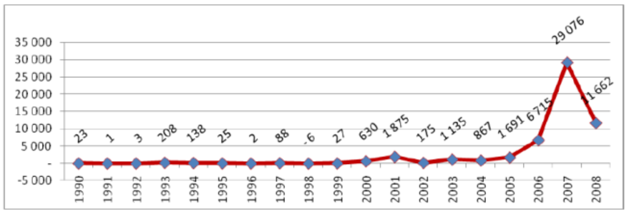

Figure 2: Outbound acquisitions by Indian Companies in Million US Dollars (computed from UNCTAD WIR 2009).

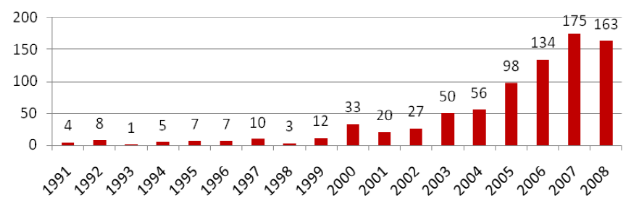

Figure 3: Number of Acquisitions by Indian Companies (Computed from UNCTAD WIR 2009).

There are several reasons that prompt us to undertake a study on cross border acquisitions by Indian Firms. Firstly India has been at the forefront of acquisitions from the emerging markets (AT Kearney researchers, 2008). India has gone through deregulations in the last two decades both in terms of allowing inward and outward investments Gopinathan S (2007). Indian companies have certain peculiarities in terms of ownership concentration by Promoters and financial institutions which make acquisition by Indian firms an interesting subject of study. (Barai, P and Mohanty, P, 2010). The deal structure of acquisitions by Indian Firms is unusual as compared to developed country acquisitions as a majority of Indian acquisitions are in cash, rather than stock, this raises questions in terms of ability to finance acquisition, the route taken to do so and the impact of additional leverage on the balance sheets of Indian Acquirers. The Indian Companies Act section 372A requires shareholder approval for investments above 60% of net worth, however many large acquisitions such as Tata Steel-Corus, Bharti-Zain deal have been routed via Special Purpose Vehicles in which case the shareholders of acquiring companies are not required to give their consent. This raises questions on protection of shareholder interests and their say in large cross border acquisitions undertaken by Indian firms. Finally research on cross border acquisitions in India is at a nascent stage prompting the need to undertake further research. (Gubbi, Aulakh,, Sarkar and Chittoor 2010)

Foreign Acquisitions by Indian Multinational Enterprises: The internationalization process in India has undergone a considerable shift since the onset of the 1990s. Whereas previously India was a destination for the technologies and brands of foreign firms acquired primarily through licensing and technology transfer arrangements, since the mid-1990s, India's participation in the global economy has transitioned to one in which it has become a more important recipient of foreign direct investment (FDI) as analyzed by Chaise, Chakraborty and Guha. It has become simultaneously a more active participant in investing in overseas markets (Pradhan 2008). As part of the latter trend – outward FDI from India – firms domiciled in India have increasingly turned to international acquisitions as their modality of foreign direct investment. This trend is notable, particularly given its contrasts to the relative lack of propensity for firms based in Asian economies, such as Japan, South Korea and Taiwan, to use acquisitions as a mode of FDI, as compared to other modes, such as wholly owned Greenfield investments or joint venture entries.

Organizational Learning and M&A: The capability that a firm has developed for managing the acquisition process plays an important role in determining the post-merger performance of firms (Zollo and Singh, 2004). Prior experience of acquisitions obtains knowledge to the acquiring firm regarding the choice of targets, the timing of acquisitions, when to opt for financial or legal resources outside the firm, and the key success factors regarding integration. The number of acquisitions made by a firm and the post acquisitions were found to have a "U-shaped" relationship. An acquisition made for the first time by a firm may induce overconfidence so that costly mistakes may be made easily. However, as the firm gains more experience, key success factors emerge and are adopted by the firm with increasing efficacy. The time elapsed between acquisitions has also received attention of scholars. A short time between acquisitions was not conducive to better performance as expected from "experienced acquirers," while a very long period between acquisitions also gave rise to the same result leading to an inverted U shaped relationship (Hayward, 2002). A too small period would not allow internalization of new knowledge, whereas too long a period would mean that such knowledge had been dissipated as low usage of knowledge had led to attrition of such routines necessary to keep the knowledge alive in the organization.

Foreign Acquisitions by Indian Multinational Enterprises: In less than two decades India has become the second fastest growing economy in the world after China. India has stood out among other developing countries of Asia not only because of recent significant increases in inflows of foreign direct investment (FDI) but also as a result of its potential to be a large outward investor (UNCTAD, 2004) with annual outflows averaging more than US$ 13 billion in recent years. Internationalisation of Indian multinational firms (MNEs), historically undertaken through Greenfield investments in the period that preceded gradual Liberalisation of India's economy in 1991, has increasingly taken place through cross-border mergers and acquisitions (M&As) since the late 1990s. This study gains importance from the arguments that the nature, motives and trajectory of internationalisation pursued by MNEs from emerging economies like India have remained a fairly neglected topic. Very little is known about the motives and strategies of these firms as compared to MNEs from developed economies (Kumar, 2006). It is therefore of crucial importance to examine internationalisation strategies of firms from emerging countries and seek to match their strategies with the concepts and approaches developed under well-established frameworks. Using panel data on foreign acquisitions by Indian MNEs over the period 2000 to 2011 this study is, to our knowledge, a first comprehensive attempt to test well established frameworks such as Dunning's eclectic paradigm in the context of OFDI by Indian MNEs. Mergers and acquisitions have become Indian MNEs' preferred mode of entry in foreign markets. According to Thomson One Banker dataset, foreign acquisitions by Indian firms have grown significantly both in value and number, especially since 2007. The annual average value of these foreign acquisitions over the last four years amounted to US$ 13 billion. However, the value of these acquisitions tends to be under-estimated as a result of the non-disclosure of the amounts involved in more than 50 per cent of acquisitions.

The sectoral breakdown of these acquisitions reveals the significance of the skill-intensive industries such as high-tech (software in particular) as well as the industrial, chemical and healthcare industries, accounting all together for 52 percent of the number of acquisitions across the period. In particular, non-financial services overtook manufacturing as the leading outward investor sector in the late 1990s, suggesting the services sector may have taken the lead in the muti-nationalisation of Indian MNEs. This also reflects the structural shift of the Indian economy towards the services sector which accounts for more than half of the country's GDP (Balasubramanyam & Forsans, 2012).

CONCLUSION:

The current study considered the valuation of emerging market companies and the role that country risk plays in the valuation process. The proposition is that, in an integrated markets environment, specific country risk can be diversified and the single global asset pricing model can be applied across the markets. The developed markets are considered well integrated and the international investors can move in and out of investments in such markets at no extra cost than would be encountered in trading within a single market.

The explanation as to why M&A deals involving Developed Countries acquirers and Emerging Market targets generate lower returns than those with India targets. Current literature explains that Emerging Markets face higher political, social and legal risks which can ultimately hurt a company that is not used to handling these situations. Furthermore, local Emerging Market competitors have a better understanding of the market and the systematic risks involved. Also there is more information asymmetry in Emerging Markets and the cultural differences between Emerging Markets and Developed countries are more accentuated than those between developed countries. Corporate Mergers and Acquisitions are very crucial for any country's economy. This is so because the Corporate Mergers and Acquisitions can result in significant restructuring of the industries and can contribute to rapid growth of industries by generating Economies of Scale, increased competition in the market and raise the vulnerability of the stockholders as the value of stocks experience ups and downs after a merger or acquisition. Although the concept of Merger and Acquisition are different from one another but both can be used as engines of growth. As a result, M&As are considered as most strategic concepts to make sure growth for the companies in the Corporate world.

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