CHAPTER 1

INTRODUCTION

1.1 INTRODUCTION TO THE STUDY

The chapter deals with the theoretical aspect of M&A. M&A theory is vast and in-depth. The motives of M&A and the impact of liberalization on M&A in India are explained in the chapter.

1.2 MERGERS AND ACQUISITIONS

M&A are used interchangeably in corporate houses, however, in academic point of view Merger is called when two firms joined together to form a new firm. For example in the year 1998 two firms that is Daimler and Chrysler combined together to form Dalmier Chrysler. Acquisition is called when a firm acquired other firms by friendly manner or hostile takeover. Example of acquisition is Renault acquired Nissan in 1999 **(Conybeare and Kim 2010).**

Types of mergers are vertical, horizontal, and conglomerate mergers **(Gaughan,2011, p. 27). Horizontal mergers** are when two firms from the same industry join together **(Sharma, 2015, p. 18). Vertical Mergers** are when two firms that have a “buyer and seller” relationship join together **(Gaughan, 2011, p.14). Conglomerate mergers** are when firms operating in unrelated business merge together **(Sharma, 2015, p. 20).**

Types of acquisitions are purchase of assets and purchase of stocks **(Gaughan, 2011, p. 27). Asset purchasing** is purchasing the asset of one firm by the other firm and **Stock purchasing** is purchasing the stock of one firm by the other firm. In India deals mostly happen in the form of stock purchase but asset purchase is also popular **(Coates IV 2014).**

1.3 MOTIVES OF MERGERS AND ACQUISTIONS

Most of the M&A studies had tried to unfold the motives of M&A. M&A have two types of motive viz value creation and value reducing motive. Sometimes single merger have both the value increasing and value reducing motive that is synergy motive and hubris motive might coexist in the same deal **(Nguyen et al 2012).** Cross border M&A were triggered by the influence of macro variables like inflation rate and exchange rate, GDP rate **(Boateng et al 2011).** Many researchers pointed out that hubris or agency related motive, empire building motive, synergy motive and industry or economic shocks, Fluctuation of business cycle and deregulation could force the firms to execute the M&A **(Oberg and Holtstrom 2006)**. Sometimes the M&A was triggered because when a company merged even other companies would choose the M&A strategy at that particular point of time **(Oberg and Holstrom 2006) and (Fumagalli and Vasconcelos 2009).** Domestic M&A could be triggered by the geographical closeness between the acquirers and the target especially when the number of firms in the particular area was high and if those firms had invested high in R&D **(Bockerman and Lehto 2006).**

Indian acquiring companies mostly chosen cross border M&A to maximize the value of stakeholder and to improve the marketing and sales skill. Researcher pointed out that one of the reasons to choose the target from the developing country was to take advantage of tax benefits offered by the countries and also to reduce the "material cost" **(Tripathy and Lamba, 2015).** However, firms from emerging economies preferred to invest in developed economy if strategies asset and natural resources are available in abundance in the developed countries and also if government interferences is less and the countries financial market is bigger in size **(Deng and Yang 2015).**

However, when emerging economies acquired firms from developing countries the preference had increased only when the government monitoring was high in those developing countries**.** High cultural difference was a hindrance for the emerging economies to acquire from developing countries. Strategic asset seeking motive was not present when the firms from emerging economies invested in developing**.** Emerging economies motivation differed when they invested in developed market and developing market **(Deng and Yang 2015).**

Chinese mostly invested in cross border to "purchase the assets" and enter the new market**.** Emerging market firms mostly invested in abroad for sharing the strategic asset and to access the new market. Favorable government policies by China, India and Indonesia were attracting more FDI in to these countries **(UNCTAD 2017). Deng and Yang (2015)** supported the resource seeking theory for cross border M&A

by emerging economy. Previously firms from emerging market acquired the target from other countries to access the new market, seeking strategically and natural resources but now the firms from emerging economies motives for acquisition had changed, certain natural resources were not available in the home market for the emerging countries. So the firms from emerging countries did acquire the firms in other countries that were rich in those natural resources **(Cogman et al 2015).** M&A were also done for the fast growth as quoted by **Alex Mandl** "acquiring is much faster than building" **(Harvard Business Review on Mergers and Acquisitions, 2001, p.4).**

For Indian firms to merge or acquire cross border was to make use of operation synergies. Indian market was not very big in size. In Indian market the growth was limited so the ambitious firms expanded the business in those countries where market would be larger and also growth would be possible**.** Competitions in the home market after the liberalization of 1991 is also the reason for overseas acquisition. Indian firms acquired abroad to gain the right to use "firm specific intangible assets" **(Pradhan and Abraham 2005).** Overvaluation and undervaluation of shares and hubris could also impact the firm"s decision to execute M&A deal **(Gregory et al 2013).** Motives for M&A also included synergy creation **(Sharma,2015, p 3).**

Parallel M&A is when customer execute merger then the supplier will also be forced to merge**.** Parallel merger could take place because merging industries mostly created a monopoly hence combined power could force the suppliers to bring down the cost of raw materials**.** So Suppliers had no other choice other than to merge**.** For example the merger takes place because the suppliers those who merged will become strong hence the supplier could create a monopoly in the market. So the supplier reduced variety of designs and other benefit offered to the customers. These forces the customers for a merger deal to offset the power of the suppliers**.** But Sometimes Suppliers merged to offer new benefits and increase service to their customer especially when the customers were more established than the suppliers **(Oberg and Holstorm 2006).**

FIGURE 1.1- MOTIVES OF MERGERS AND ACQUISITIONS

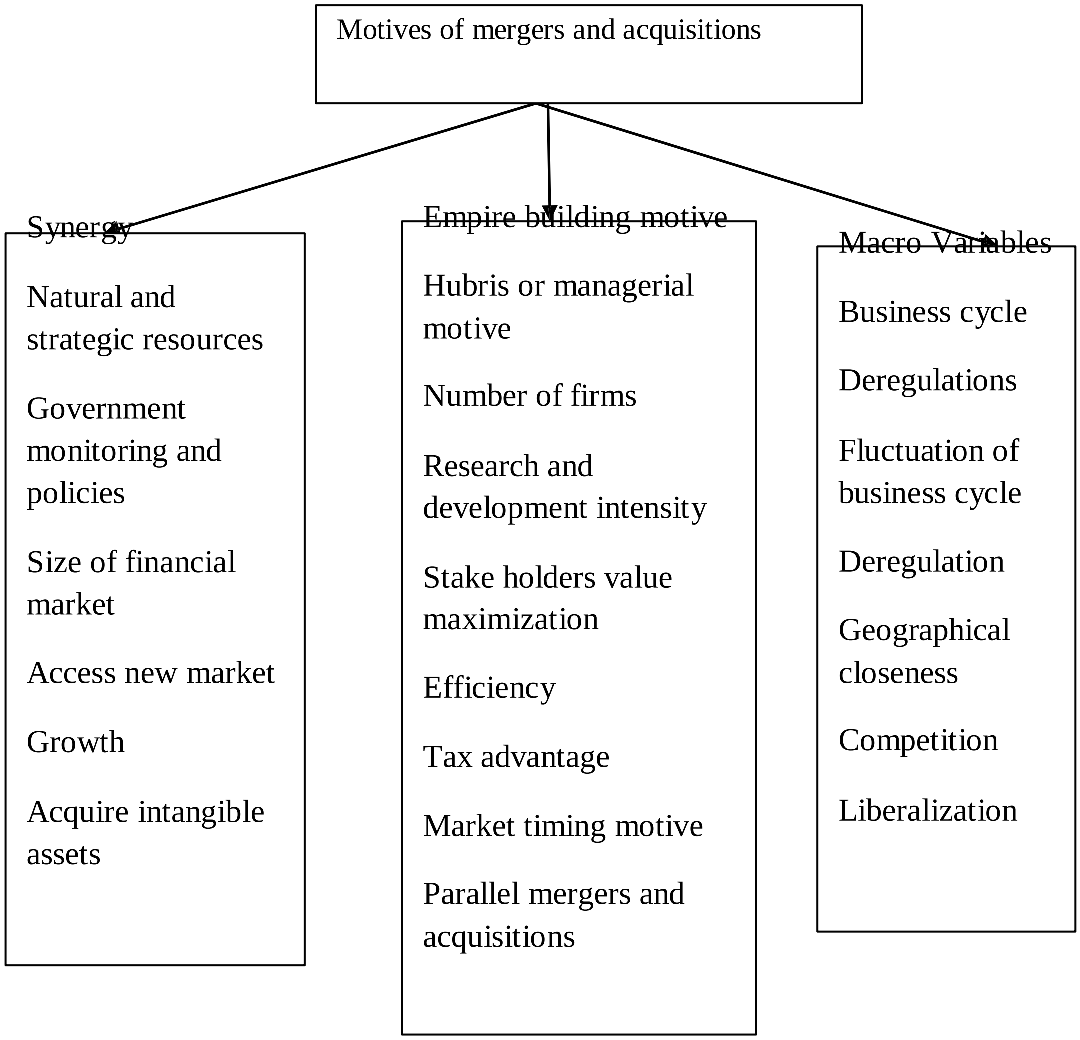

Figure 1:1 Compiled from the Previous Literatures

1.4 IMPACT OF LIBERALIZATION IN INDIA

Second World War period was crucial for Indian Business houses**.** It was understood that finally India was going to be independent from the British rule. British corporate houses operating in India were selling their ownership of shares of the Britain firms operating in India and so the Indian corporate houses purchased those shares **(Kar and Soni).**

Most of the shares of the insurance, banks and investment companies were acquired because the corporate houses wanted fund to engage in more M&A deals and these insurance, banks and investment companies could supply more funds to purchase the shares of many other companies**.** However, the Government of India made policies in 1960 and 1970 to stop the M&A in India and the Indian government policy successfully controlled the M&A in India**.** Even after the 1970 anti M&A policies there were conglomerate mergers occurring because the government tried to stop only horizontal and vertical M&A. During 1970‟s, Sick firms solace was M&A. The Indian government also welcomed the merger of sick firms**.** Life Insurance Company was established in the year 1956 by merging 243 insurance firms. Many sick textile firms were also merged to form national textile corporation **(Kar).**

India was facing a fiscal deficit during 1990‟s and also the growth of Chinese market compelled India to liberalize the Indian economy **(Nagaraj 1997).** Not only India but the whole world was facing a fiscal deficit in 1980‟s hence for many countries foreign investment became a necessity so in order to attract foreign investment most of the countries did three reforms such as "financial integration, liberalization and deregulation" **(UNCTAD Report 1990).**

Fiscal deficit in the world was because of inflation, deflation, and recession that happened in 1989 which also resulted in high interest rate. The Wall Street had a crisis in 1987 all this had an impact on the developing economy **(UNCTAD 1990**). In India, the M&A had taken in three phases that is in early 1990‟s Indian firms were mostly making domestic deals, then from mid 1990‟s to 2000 firms started investing in overseas firms along with domestic deals and then from 2000 to 2008, Indian firms were mostly investing in outbound deals **(Saraswathy 2015).**

Before the liberalization of Indian economy, the firms were mostly choosing Greenfield investment but then after the 1990 liberalization the cross border M&A became popular in India **(Kumar 2000).** During 1990‟s that is in the beginning of merger wave in India half of the deals were in manufacturing sector but these firms had a total asset of only100 crore or below that **(Beena 2000).** During 1995 to 2000 the firms in India preferred out bound M&A mainly between firms operating in the same industry to increase the size of the firms and to avoid other hostile takeovers, the other reason was to increase the capital availability for the firms **(Beena 2004).** During the first three wave period on India that is from1990 to 2001 the M&A deals were either vertical or horizontal hence the deals were to achieve synergy **(Kar and Soni)**. However, most of the deals that had taken place in India were horizontal and only very few deals were vertical; that is from among 256 deals only three deals were vertical and those deals had taken place in food and beverage industry. Foreign Firms had joint ventures with Indian firms but after some years the foreign firms had entered in to horizontal acquisition and later the foreign firms acquired Indian firms completely especially in the automobile sectors **(Kumar 2000).**

Main reason for the sudden increase in M&A in India was mainly the liberalization of Indian economy by relaxing MRTP Act and FERA **(Beena 2004; Beena 2000)**. FERA act, 1973 and MRTP Act 1969 had restricted the foreign investment to India**.** According to FERA act, the companies from outside India could acquire only a 40% of shares to the maximum from Indian company. MRTP Act gave authority to the government to put a stop to an acquisition if the government authority believed the merger or acquisition would create monopoly **(Kumar 2000).** One of the main attraction of 1990"s liberalization was not only the Relaxation of MRTP but also the (MODVAT) tax that is according to MODVAT, manufactures get tax deduction for certain inputs produced domestically **(Panagariya 2004).** During 1995 Indian acquiring firms were mostly using external source to finance M&A but in 2002 the Indian acquirers financed by using internal sources (**Beena 2004).**

Before the „1990"s liberalization" that is from 1970 onwards M&A deals were used by Indian companies to grow. But after liberalization, the Indian companies getting engaged in M&A deals had increased. In India, MRTP companies and NON MRTP companies had executed M&A deals but before liberalization NON MRTP companies were active in M&A but after the 1980"s liberalization policies, the MRTP companies that engaged in M&A deals had increased. Until 1990"s liberalization, manufacturing firms participated more in M&A deals than the non manufacturing firms**.** However, after 1990"s liberalization the financial firms in India became active in M&A deals. Finance firms wanted to get listed in stock market and for this the financial firms had executed M&A deals with the firms listed in stock market. This was the main reason for the Indian finance firms to get engaged in M&A deals after the 1991 liberalization**.** Private firms also started engaging in M&A deal from 1991 but the percentage of private firms engaged in M&A deals were more in non manufacturing sector compared to the manufacturing sector**.** Most of the MRTP firms engaged in M&A were big in size. Firms engaged in M&A deals had a superior financial position in 1990‟s than those firms which had not engaged in M&A, but the number of firms engaged in M&A deals in India was less in the 1990‟s **(Beena 2000).**

Competition act 2002 replaced the MRTP Act 1969. Buyback of shares were also allowed by the Indian government in the companies‟ act 1956 **(Kar).** In 1990‟s FDI to India had increased from "half a billion dollar to more than 3 billion dollar a year" and also cross border M&A had increased in India **(Beena 2000)**. In early 1990‟s when comparing the share of domestic firms in India and cross border merger in India, surprisingly the percentage of cross border M&A were lesser than the domestic M&A **(Saraswathy 2010).** But foreign firms were involved in cross border M&A in India only after relaxing the FERA in 1992 **(Beena 2000).** 1n 1994 SEBI had framed "substantial acquisition of shares and takeover 1994" regulations also known as takeover code 1994**.** Financing during those period that is from 1990 to 2000 by Indian firms were "domestic borrowings or internal funds**".** Even though the Indian government had framed SEBI takeover code to protect the minority shareholders interest it did not control the deal by "framing antitrust or competition policies" **(Kumar 2000)**.

In 1991 Industrial liberalization, India‟s main motive was to remove the license required to enter in certain businesses and also stop the economies of scale benefits enjoyed by the firms in manufacturing sectors. India also increased the foreign ownership in India firms from 40 to 51%**.** Foreign direct investment in India had increased after the 1991 liberalization for example before the liberalization, the inflow of FDI was only $100 million but after 20 years of liberalization, the inflow has increased up to $ 35 billion. Out flow had also increased from $ 0.5 billion in 1991 to $ 20 billion in the year 2008 – 2009**.** From 2007 there was a change in the outward investment flow of India that is until 2007 the Indian firms mostly invested only in developed countries but from 2007 Indian firms invested in developing countries like Africa, commonwealth of independent states and Latin America, Eastern Europe. During 2000 the government had incorporated certain policies to improve the growth of the manufacturing sector. Indian "Industrial policy 1948" strictly controlled the Indian industries. However, the "Industrial policy of 1956" encouraged foreign investment again and the "Industrial policy 1980" was to increase the export and import activities in India**.** Industrial delicensing in 1980‟s had impacted the growth of organized manufacturing sector. In 2001, the manufacturing sector had also experienced deduction in Tariffs**.** From 2000 onwards the manufacturing sector in India has grown on 8% annually**.** In 1971 onwards Indian rupee was linked to US dollars. FERS 1973 was modified and became FEMA in 1999 **(Banga and Das 2012, UNCTAD).**

Reasons for the increased FDI is first of all the 1980 recession, after the recession corporate from all over the world began to invest in other countries**.** Other reason is that until 1985 only the United Kingdom and the United states were interested in foreign investments but then after 1985 countries like Japan, Singapore, Taiwan provinces of China and Honk Kong started investing in foreign market. The main reason for Japan‟s investments in foreign market was that yen appreciated in 1985 and so it became less expensive for Japanese‟s firm to acquire the assets from other foreign market and also "current account surplus" is the other reason. Other reason is that many countries had experienced an appreciation in their home currency**.** Countries also had to deal with the increased cost of production and also certain countries framed policies to attract the foreign investment in the home export market during the period 1985 to 1989.In the year 1985 to 1989 the spurt in FDI was manly in the form of cross border M&A. Integrated European economy in 1992 was also a reason for the increased FDI [redacted]**UNCTAD 1991).**

1.5 CONCLUSION

The Introduction Chapter tells about the types of M&A, the Motivation behind the firms to choose the M&A strategy and also the Indian waves of M&A. The present Chapter helps to understand the Indian Story of M&A.

CHAPTER SCHEME

The first chapter deals with the introduction of the M&A

The second chapter deals with the review of the literature

Third chapter explains the research methodology

Fourth chapter deals with the analysis and interpretation of the present study

Fifth chapter includes findings, suggestions, implications for future research and conclusion.