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M&A Strategies – Empirical Analysis of Indian Scenario

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Abstract: Inorganic growth by means of Mergers & Acquisitions (M&As) activities has gained significant traction in the recent past, with many corporates favoring this path worldwide. In India, the regulatory environment during 1970's to 1990's had not been conducive to M&As activities. India started catching up with the global trend of M&As post-financial reforms in 1990s. Since then, various structural changes in the economy like change in interest rates, market size, liquidity, *among others*, and regulatory changes like replacement of the MRTP Act by Competition Act, 2002 have favored the number of M&A deals. Indian corporates are assigning a lot of importance on the inorganic path of growth and treating M&A as a focal strategy point for value creation and improving shareholder value. There are many financial and non-financial aspects that influence strategy as well as the success of a typical M&A deal. This paper aims at studying the success and failure of M&A deals in terms of the impact of various financial ad non-financial factors. The study uses simple ordinary least squares method of estimation. Results are in line with theoretical expectations in terms of coefficients with reasonable goodness of fit.

Keywords: Growth Strategy, Corporate M&As, Value Creation, Shareholder Value

JEL Classification Number: G12, G32, G34

1. Introduction

Indian Companies have been adopting Mergers and Acquisitions (M&A) as a strategy to sustain the business model and to transform the traditional business into new age innovative business delivery models. In the last 30 years, mergers and acquisitions activities have evolved and are maturing in the international scenario. In India, the regulatory environment during1970's to 1990's had not been conducive to mergers and acquisition activities. India started catching-up fast post-financial reforms in 1990s with the replacement of the MRTP Act by the Competition Act, 2002. Also, the 2008 crisis had a deepening impact on the economy and, post-crisis, there were structural changes in the economy like change in interest rates, market size, liquidity, *among others*.

In the corporate field, top managements envisage M&As as a critical activity for rapid growth with several benefits to both target and acquiring company. Inorganic mode of growth is increasingly becoming a central part of strategy for organizations in developing their markets; while the global market continues to be a focal strategy point for value creation and improving shareholder value. However, the success rate has still not significantly increased or got better in developed market even as developing market struggles to make M&A successful.

M&A research methods and models have evolved around quantitative, qualitative and survey based. There have been many studies which identified the issues and challenges in the M&A process. Most of the data and information are captured by various data service providing entities, and have been analyzed in terms of their success and failure. Success and failures of mergers and acquisitions, to some extent, can be captured by analyzing number of cross-border deals by predominantly looking at the pre and post-merger valuation of the firm, and also the stock price behavior of the acquired firm. Global research has been also aimed at capturing reasons of success or failure of M&A that can be attributable to valuation, regulations or financial impacts.This study aims to understand how various financial and non-financial determinants affect the cross border mergers and acquisition deals for the Indian market.

2. Literature Review

The literature review mainly covers impact of various financial and non-financial factors on M&A deals. While many studies states that acquirers mostly focus on financial due diligence, risk assessments and investor relations, few studies have focused on various non-financial factors such as patents/ trademark filing, R&D expenditure of host countries as a key determinant influencing the M&A deals. Mitchell and Mulherin (1996) found out that M&A activities in USA in any industry are directly related to the economic shocks like deregulation, financial innovations etc. borne by that industry. They documented that the takeover and restructuring activity in a particular industry tends to cluster within a narrow range during the sample period.

Giffin and Schmidt (2002) states that the hurdles to success relate directly to people issues such as workforce management, cultural integration and finessing these soft issues is the hard part of integration. The authors found that the probability of success can be improved by getting Human Resource (HR) team involved before integration planning begins. Senior HR executive should provide advice on essentials as retaining key talent, communicating to employees, and taking steps to combine cultures.

Aruna and Nirmala (2013) studied the financial performance of selective acquiring IT companies in India. Although Indian companies across various sectors (pharmaceutical, metals, automobiles, etc.) have made successful acquisition across the globe, mergers and acquisitions in IT companies helped them to gain improvement of managerial efficiency, achievement of economies of scale or scope, increased market power and increased revenue growth. A comparative study of the pre-and post-merger financial performance appraisal of acquiring Indian IT companies was carried out. The researcher selected randomly three cases of mergers occurred in the Indian IT sector and used ratio analyses to examine the pre-and post-merger financial performance appraisal of acquiring IT companies in India.

Bhargavi *et al* (2016) examined locational determinants of outward foreign direct investment of Indian pharmaceutical companies and have concluded that strategic assets like patents/ trademark filing, R&D expenditure of host countries as a key determinant influencing the Indian M&A pharmaceutical deals. Phillips and Zhdanov (2012), studies the nature of R & D expenditure that large and small firms carry out and innovate various models and processes. It was observed that small firms carry out innovations and large firms tend to acquire those small firms. Large firms usually cannot increase their R&D expenditure in a major way and hence they prefer acquisitions route to gain the innovative products and processes from small firms.

Even strategic technology alliances play a role in the mergers and acquisitions of an organization, even though the impact is very minimal (John Hagedoorn and Bert Sadowski, 1999). Customer experience is greatly impacted by the M&A deals as customers demand consistent and seamless services from the merged company and any deviation from this may result in loss of customer loyalty (Miles and Rouse, 2011). They identify five customer-focused initiatives that help companies avoid high customer attrition post-merger and improve the customer experience.

Simone (2016) highlighted corporate development practices of Mergers and acquisition in the United States of America. The paper also provided with a description of various types of mergers and acquisition. Government guidelines overseeing mergers and acquisitions were addressed along with anti-trust regulations and corporate procedures. This study also summarizes the human resource issues that result from corporate mergers and acquisition.

3. Data and Methodology

The data sources include reliable private databases and other publicly available information on the mergers and acquisitions. The variables that were used to analyze are non- financial parameters like trademarks, patents, governance indicators, etc., and macro-economic parameters like Gross Domestic Product, inflation and FDI inflows and outflows. There are many financial parameters that are considered while making decisions regarding whether to go ahead with M&A deals or not. These parameters include share price, revenue and profit, valuation of acquired company, and financial strength of acquiring company. However, this study focuses more on seven non-financial listed below and three economic factors such as Foreign Direct Investment, economic growth, and inflation.

The non-financial parameters that are considered for the study include political stability and absence of violence/terrorism, government effectiveness, regulatory quality, rule of law, control of corruption, trade mark applications residents and non-residents and patent applications

The study uses data for the period 2004-2017 from World Bank data, IMF data and UNCTAD datasets

The dependent variables for the study include Net cross border M&A deals by purchaser and Net cross border M&A deals by seller

Three models are developed for each dependent variable, i.e., M&A deals by purchaser (Y_1) and by Seller (Y_2).

Model 1:$Y_1 = f(x_1, x_2, x_3)$
Model 2: $Y_1 = f(x_4, x_5, x_6)$
Model 3: $Y_1 = f(x_7, x_8, x_9, x_{10}, x_{11})$
Model 4:$Y_2 = f(x_1, x_2, x_3)$
Model 5:$Y_2 = f(x_4, x_5, x_6)$
Model 6:$Y_2 = f(x_7, x_8, x_9, x_{10}, x_{11})$

Where $x_1 =$ Economic Growth; $x_2 =$ Inflation; $x_3 =$ FDI (outflow/inflow); $x_4 =$ Trade Mark applications residents; $x_5 =$ Trade Mark applications non-residents; $x_6 =$ Patent applications; $x_7 =$ Rule of Law; $x_8 =$ Control of Corruption; $x_9 =$ Political Stability and Absence of Violence/Terrorism; $x_{10} =$ Government Effectiveness and $x_{11} =$ Regulatory Quality

4. Results

Ordinary Least Squares (OLS) method of estimation was used on the data and results were given in Table 1.

Table 1: Results of OLS method (Model 1:Y_1 = f(FDI outflow, GDP, Inflation))

Variables	**Coefficient**	**SE**
FDI outflows	0.004207*	0.001658
GDP	7.488	5.2312
Inflation	5.657214	4.580206
R^2	0.596502	
Adjusted R^2	0.475453	
F Statistic	4.927756	
DW	1.734113	

Note: * denotes significance at 1% level.

Table 2: Estimation Results (Model 2:Y_1= f(Trademark applications Resident, Non-resident, Patent applications))

Variables	Coefficient	SE
Trade Mark residents	-0.002890	0.001663
Trade Mark non-residents	-0.000156	0.000217
Patent applications	0.002438	0.002598
R^2	0.280723	
Adjusted R^2	0.064940	
F Statistic	1.300948	
DW	1.852626	

Note: * denotes significance at 1% level.

Table 3: Estimation Results (Model 3: Y_1= f (political stability, government effectiveness, regulatory quality, corruption control, rule of law))

Variables	Coefficient	SE
Political Stability	196.4801	182.2793
Government Effectiveness	386.6182	241.4192
Regulatory Quality	-10.41542	244.1246
Rule of Law	518.0115*	220.4821
Control of Corruption	-458.9117	357.9474
R^2	0.565910	
Adjusted R^2	0.294603	
F Statistic	2.085869	
DW	2.455153	

Note: * denotes significance at 1% level.

Table 4: Estimation Results (Model 4: Y_2 = f(FDI outflow, GDP, Inflation))

Variables	Coefficient	SE
FDIin	0.001114*	0.000470
GDP	1.916316	3.436769
Inflation	1.829180	2.407537
R^2	0.385102	
Adjusted R^2	0.200633	
F Statistic	2.087623	
DW	1.165285	

Note: * denotes significance at 1% level.

Table 5: Estimation Results (Model 5: Y_2= f(Trademark applications Resident, Non-resident, Patent applications))

Variables	Coefficient	SE
Trade Mark residents	-0.000706	0.000532
Trade Mark non-residents	-5.81E-05	6.95E-05
Patent applications	0.003366*	0.000831
R^2	0.653760	
Adjusted R^2	0.549889	
F Statistic	6.293913	
DW	1.194923	

Note: * denotes significance at 1% level.

Table 6: Estimation Results (Model 6:Y_2= f (political stability, government effectiveness, regulatory quality, corruption control, rule of law))

Variables	Coefficient	SE
Political Stability	215.3896*	98.85348
Government Effectiveness	175.7564	130.9261
Regulatory Quality	-2.369268	132.3933
Rule of Law	144.2518	119.5715
Control of Corruption	-369.7656	194.1216
R^2	0.399188	
Adjusted R^2	0.023681	
F Statistic	1.063063	
DW	1.378782	

Note: * denotes significance at 1% level.

5. Discussion and Conclusion

Gross domestic product (GDP) and inflation have positive impact on cross-border M&A deals for both purchaser and seller, though not very significant, indicating that a good economic environment in the country of the acquired company is much favorable for the success of M&A deal. FDI inflow and outflow had significant coefficients in models 1 and 4. While FDI inflow impacts the deals for seller, FDI outflow affects the deals for purchaser. Trademark applications for residents and non-residents have negative impact on both cross-border deals for seller and purchaser. However the impact is very negligible, and can be ignored. Patent applications had positive impact on cross- border M&A deals both for seller and purchaser, however the coefficients are insignificant. Political stability, government effectiveness and rule of law positively impact the cross-border deals for both sellers and purchasers; whereas the regulatory quality and control of corruption adversely impact cross-border deals for both sellers and purchasers. In conclusion, both economic and non-financial determinants have positive/negative impact on the success of M&A deals. Few determinants have significant impact on the success of M&A deals; while others may not be that impactful. For cross-border M&A deals for purchaser (dependent variable Y_1), goodness of fit is highest at 0.59 for model 1. For cross border M&A deals for seller (dependent variable Y_2) goodness of fit is highest at 0.65 for model 5. The research concludes and proposes to incorporate non-financial factors also for assessing the success or failure of M&A strategy in the Indian context.

The study used annual data for the time period 2004 to 2017. While it is a good representation of the actual model, due to the limitation of number of observations used for this study, this model needs to be further strengthened with greater number of observations and cross-country data to enable to use other methods of estimation such as panel data or time series models.

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