

AN EMPIRICAL STUDY ON MERGER PRACTICES IN INDIA

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Abstract: *Merges and acquisitions (M&As) have long been a popular element of corporate strategy and represent an important alternative for strategic expansion through inorganic growth. This paper investigates motives and trend of merger activities of Indian companies during the period 2003-08. The survey findings show that the primary motivation for mergers is to achieve operating synergies. The findings reveal that domestic merger landscape during the period is dominated by mergers of subsidiaries with the parent companies. The study provides insights about the motives for such mergers. The results of empirical survey show that the trend of mergers of subsidiaries with the parent companies during the period is an attempt for consolidation and a response to the changing regulatory framework. Parent subsidiary mergers have implications for corporate governance. Management of companies can adopt the strategy of merging large number of unlisted subsidiaries to improve the corporate governance structure of the companies.*

Index Terms: *Mergers & Acquisitions, Synergies, Corporate Governance.*

INTRODUCTION

Mergers and acquisitions (M&As) have long been a popular element of corporate strategy and represent an important alternative for strategic expansion through inorganic growth. Merger is a combination of two or more firms in which only one firm would survive and the other would cease to exist. Mergers and acquisitions are the most popular means of corporate restructuring. Mergers have played an important role in the inorganic growth of a number of major corporate the world over. This paper investigates motives and trend of merger activities of Indian companies during the period 2003-08. For better exposition, the remaining part of the paper is organized in the six sections. Section II reviews the relevant literature and briefs the objectives of the study; section III presents the macroeconomic scenario of mergers during 2003-2008, research design, sample selection for the study, and limitations have been described in section IV; section V summarizes the empirical results; finally, section VI concludes and discusses implications.

II. Literature review

Numerous studies have been conducted to answer a fundamental question: Why do mergers take place? The existing literature as well as empirical work on motives of mergers does not offer a conclusive explanation for why do mergers occur. This section discusses the relevant literature about the motives for mergers. Berkovitch and Narayanan (1993) have identified synergy, hubris and agency as three major motives of takeovers. They have tested three hypotheses related to these motives using a sample of 330 tender offers of US firms during the period 1963 -1988. They have observed that the synergy is the primary motive associated with positive wealth effects for acquirers while a zero wealth effect is driven by hubris. Agency is the major reason for value reducing acquisitions. The managerialism hypothesis suggests that managers acquire firms for their own personal motives than the economic gains to the acquiring firm. Managers undertake acquisitions to maximize their own benefits at the expense of the shareholders of the firm Marris (1964).

The hubris hypothesis proposes that acquiring firm managers make mistakes in evaluating target firms, but undertake acquisitions showing that their valuations are appropriate. Roll (1986) has stated that this hubris causes them to overpay for the acquisition of the target. These deals have no synergy gains as they are motivated by managers' mistakes. Eun, Kolodnu, and Scheraga (1996) have investigated the synergy hypothesis for cross border acquisitions of US firms during 1979-1990. The study has concluded that cross-border acquisitions are synergy creating activities.

Mueller and Sirrower (2003) tested four hypotheses: the synergy hypothesis, the hubris hypothesis the market-for-corporate-control hypothesis and the managerial discretion hypothesis to investigate the motives of merger. They have tested the hypotheses for 168 mergers between large US companies during the period 1978-1990. They found significant evidence for the managerial discretion and hubris hypotheses and non-significant support for the market-for-corporate-control hypothesis as a motive for merger. Synergy hypothesis as a motive for merger has been rejected in this study. However, a number of empirical studies found significant evidence for synergy as a merger motive.

Kumar and Rajib (2007) have examined a sample of 227 acquirer and 215 targets companies during the period 1993-2004. They have observed capital structure characteristics as a main motive for the merger for both acquirer and target companies in India. They reveal that firms with tighter liquidity positions are more likely to become a target.

Goold and Campbell (1998) have pointed out that shared know-how; pooled negotiated power, coordinate strategies, vertical integration, shared tangible resources and combined business creation bring synergy for merged entity. Eccles, Lanes and Wilson (1999) have suggested cost savings, process involvement, revenue enhancement, tax benefits, financial engineering as main sources of synergy.

III. Research Design

The research design consists of survey instrument, sample selection and limitation of study.

Survey Instrument:

A questionnaire was developed on a set of questions based on an extensive review of literature. During October 2008 – December 2008, a preliminary version of this survey was pre-tested by a personal interview of 20 CFOs, directors (finance, legal) and company secretaries. The questionnaire was modified based on that interaction and feedback. The survey explores four major issues involved in merger practices in India. The first issue involves background data. The other relates to types and motives for engaging in mergers. We have investigated the sources of synergies expected from mergers. The last issue examined is the motives behind the mergers of wholly owned subsidiaries with the parent company. In reporting the survey results, we address two major questions. First, what are the motives behind corporate mergers? Second, what are the reasons for a wave of merging the subsidiaries with the permanent company during sample period? Finally, cost optimization benefits of mergers & acquisitions have been analyzed.

Sample Selection:

As stated earlier, 568 acquirer companies completed mergers of 893 target companies during 2003-2008. We checked the names and address and email of the company secretaries, chief financial officers, director finance, and head-investor relations from the websites of the acquirer companies. We could obtain the email address of 565 companies. We requested 275 companies from Mumbai, Delhi, Gurgaon, Noida, Faridabad, Chandigarh, Ludhiana, Panchkula for an appointment for a personal interview and mailed the questionnaire to the 290 companies. Interview of 132 persons were personally scheduled and 20 responses were received through mail. Though the response proportion is more than one-fourth (27%) it should not be considered as poor/low response rate. The reason is that the survey response to the subject of finance is usually not encouraging.

Limitations: The study is not free from potential limitations. One limitation is that our study addresses only limited number of issues in the survey. This is not a comprehensive survey on various hypothesis prevalent in the area of mergers and acquisitions. We limit the scope to the amalgamations only.

V. Empirical results: We presents our results in three parts: characteristics of responding firms, motives for mergers and motives for mergers of subsidiaries with the parent company. The 152 respondent acquirer companies merged 254 target companies during 2003-2008. Mode of payment in 125 amalgamations was shares/stock of the acquired company. Table 4 describes the respondents' profile.

Table 4: Respondent's profile

Respondents Designation	Number (percentage)
Chairman, Executive Directors (Finance) and Chief Financial officers	49 (32.3%)
Vice Presidents, Head and Chief Legal Officers	35 (23%)
Company Secretary and Deputy General Manager	38 (25%)
General Manager (Finance, Investor Relations)	30 (19.7%)
Total	152 (100%)

Table 5. Frequency distribution of number of companies merged by respondent companies 2003-08

Number of Mergers	N	Percent
1	77	51
2-4	59	39
5-7	11	8

8-10	3	2
11-15	2	1
Above 15	0	0
Total	152	100

It is evident from Figure 3 that characteristics of respondent companies are highly representative of sample characteristics regarding affiliation/form of ownership. Table 5 shows the results involving number of mergers. The findings show that almost half of (50 per cent) of the responding firms have been involved in multiple mergers.

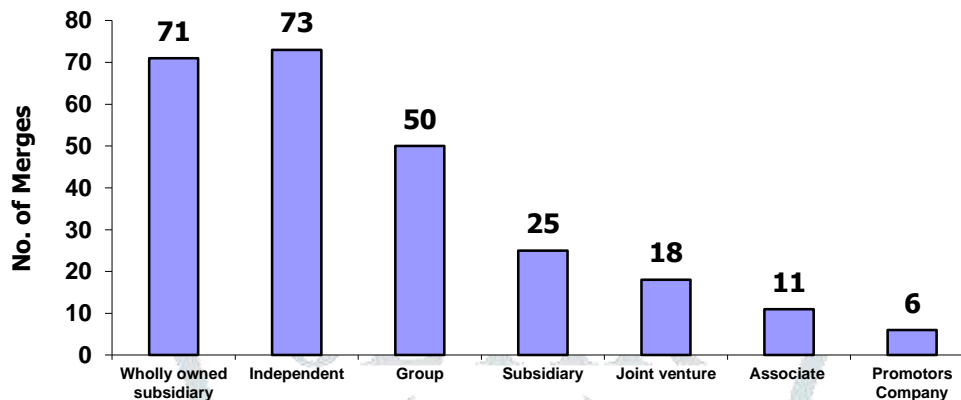


Figure 3. Affiliation/form of ownership of respondent target Co. merged 2003-08

Table 6 reports the results involving ranking of motives of merging the other firms. The respondents were asked to select three most important motives, in order of priority. They were given eight choices along with ninth as ‘any other’ option, where they could specify any other motive for merging other firm. Table 6 reports the choices made by the respondents regarding the primary, secondary and tertiary motives for mergers. A weighted index has been calculated for each motive for ranking purpose. For every statement, the number of respondents choosing it as primary motive has been multiplied by three, as secondary motive by two and as tertiary motive by one. These three numbers have been further summed up and then divided by six to get the value of the index. Using this weighted index, the statements are ranked in the descending order. Table 6 reveals that the primary motive of the mergers is to take advantage of synergies. The second highest-ranked motive of merger is to consolidate. The survey findings show that the primary motivation for mergers is to achieve synergies. Synergy may arise from various sources. To investigate further we asked another question about the most important source of synergy.

Table 7 represents the ranking of sources of synergy as revealed by respondents. The respondents were asked to select three most important sources of synergy, in order of priority. They were given seven choices along with eighth as ‘any other’ option, where they could specify any other source of synergy arising out of merger. Operating synergies has been chosen by the respondents as the top ranked source of synergy. The second highest-ranked source of synergy is increased market power. The findings are in agreement with Singh and Montgomery (1987); they have observed that synergistic gains in domestic acquisitions are derived from increase in operational efficiency and increase in market power. The results also match with Ghosh (2004) who has observed that market power is a rationale for acquiring other companies. Keeping into consideration the trends of mergers as exhibited in Figure 2, around 40 per cent mergers are of wholly owned subsidiaries. The results are in agreement with other studies Jarrel and Bradley (1980), Schipper and Thompson (1983) who investigated that regulatory changes play a key role in influencing the mergers and acquisition strategies of firms. It has been further explored that what regulation changes have had effect on this practice.

Table 6 Management view of respondent companies on motives for mergers

Motive No.	Motives for mergers	Prime motive	Second motive	Third motive	Weighted index	Rank
1	To take advantages of synergy	71	38	30	53.2	1
4	To consolidate	14	55	49	33.5	2
5	To restructure organization	9	20	29	16	3
6	To adopt as a strategy for inorganic growth	8	14	25	12.8	4

8	To rehabilitate a company through Board for Industrial and Financial Reconstruction (BIFR)	24	0	0	12	5
7	Exit of joint venture by other partner	17	0	0	8.5	6
3	To reduce tax on the combined company	4	13	10	8	7
2	To diversify	4	12	9	7.5	8
9	Any other (specify)	0	0	0	0	9

Note: The weighted score = $[(\text{Prime Motive} \times 3) + (\text{Second Motive} \times 2) + (\text{Third Motive} \times 1)]/6$

Table 7. Management view of respondent companies on sources of synergy.

Synergy No.	Sources of Synergy	Prime Motive	Second Motive	Third Motive	Weighted Index	Rank
2	Operating economics	26	19	10	21	1
4	Increased market power	12	10	17	12.2	2
1	Financial economics	11	12	13	11.7	3
8	Other (specify)	9	11	11	10	4
3	Enhanced Managerial capabilities	10	6	6	8	5
7	Improved Technology	1	7	7	4	6
6	Avail Cross-selling opportunities	2	4	6	3.3	7
5	Location economics	1	2	7	2.3	8

Note: The weighted score = $[(\text{Prime Motive} \times 3) + (\text{Second Motive} \times 2) + (\text{Third Motive} \times 1)] \div 6$

Table 8. Management view of respondent companies on motives of merger of wholly owned subsidiary

Motive No.	Motive of merger in case of wholly owned subsidiary	Prime Motive	Second Motive	Third Motive	Weighted Index	Rank
2	A Composite scheme of arrangement for consolidation	22	21	13	20.2	1
4	A response to changes in regulatory framework	16	19	13	16.5	2
5	To eliminate duplication of compliance cost	8	10	17	10.2	3
1	To reduce complexity of organizational structure	12	6	9	9.5	4
3	Tax savings due to elimination of dividend distribution tax	6	8	9	7.2	5
6	Other (Specify)	3	4	7	4	6

Note: The weighted score = $[(\text{Prime Motive} \times 3) + (\text{Second Motive} \times 2) + (\text{Third Motive} \times 1)] \div 6$

The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company. These changes are likely to result in an increase in

administrative and compliance cost of having a number of subsidiaries. The Third motive revealed by respondents is to eliminate the duplication of compliance cost. It appears that these changes in regulations have influenced the merger strategies of Indian companies

VI. CONCLUSION AND IMPLICATIONS

We have surveyed managers (management) of Indian companies engaged in mergers to know their view about the motives of merging other firms. Based on the survey evidence, we conclude that primary motivation for mergers is to achieve operating synergies. For unlisted wholly owned subsidiary motive of merges is to achieve consolidation and a response to changing regulatory framework. Our results suggest some implications for practitioners and researchers. This exploratory study suggests a need for detailed investigation of the synergy motive in Indian context. Parent –subsidiary mergers have not been a widely investigated in the finance literature, but have implications for corporate governance. The Present study suggests that issue should be deliberated more in Indian context. Management can merge the large number of unlisted subsidiaries to achieve consolidation and form a good governance structure. This practice will not only achieve savings in compliance cost but also improve the corporate governance standards of the company. Management of companies can adopt the strategy of merging large number of unlisted subsidiaries to improve the corporate governance structure of the companies.

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