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An Empirical Study of Corporate Mergers in India

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Abstract

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. 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. Parentsubsidiary 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.

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 synergyi, 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.

Mukherjee, Kiymaz amd Baker (2004) conducted a survey of US firms during 1990-2001 to study the motive for mergers and acquisitions. Their empirical evidence shows that primary motivation for mergers and acquisitions is to achieve operating synergies.

Ramakrishnan (2008) studied a sample of 87 domestic mergers of Indian companies during the period 1996-2002 to study the long-term performance of merged companies. The study indicates that operating synergy is the primary motive of the mergers in India.

Seth, Song and Pettit (2000) investigated 100 acquisitions of US firms by foreign firms during 1981-1990 to explain the motive for crossborder acquisitions. Their findings lend support to the synergy hypothesis as the main motive. The study also revealed that hubris also played an important role in these deals.

Eun, Kolodny, and Scheraga (1996) have investigated the synergy hypothesis for crossborder acquisitions of US firms during 1979-1990. The study has concluded that cross-border acquisitions are synergy creating activities.

Ghosh (2004) suggests that market power is the source of value creation and a rationale for merger and acquisition 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-forcorporate-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.

Wasserstein (1998) has identified five major causes of mergers. He states that the process of merger is driven by the forces of technological change, regulatory and political reforms, fluctuations in financial markets, the role of leadership, and the tension between scale and focus. *Trautwein (1990)* classified the theories of merger motives into seven groups: efficiency, monopoly, empire building, raider, valuation, and process and disturbance theory.

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, coordinated 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.

Solvin and Sushka (1997) examined the motives of parent-subsidiary mergers by using a sample of 105 US publicly traded firms during 1970-1993. They concluded that parentsubsidiary mergers facilitate corporate restructuring and reallocate the resources to higher valued uses.

In this study, we survey chief finance officer (CFO), director & head (finance), company secretary, head (investor relation officer) to obtain direct evidence of managerial perspectives about mergers. Several reasons underlie the importance of taking the importance of conducting an exploratory study by conducting a survey. The scope of our study is limited to investigate the motives of mergers among Indian companies. Specifically, the main objectives of the study are to:

- analyze the trends of mergers by type of targets, industry and status during 2003-2008;
- analyze mergers by type of targets;
- identify primary motivations for mergers during 2003-2008; and
- explore further the motivations of mergers of wholly - owned subsidiary with the parent company.

III. Macroeconomic scenario of mergers

There is no comprehensive database in India which reveals the details of merger in corporate sector. Prowess database by Center for Monitoring Indian Economy (CMIE) covers the elementary details of companies merging other companies. We started investigating the macroeconomic overview of mergers on the basis of this information. There are 1,632 mergers announced as reported by Center for Monitoring Indian Economy (CMIE) database prowess during January 1, 2003 to December 31, 2008. There are multiple mergers in one announcement by the same company. 1,016 companies were involved in mergers of 1,632 companies.

There are 1,158 merger announcements made by companies listed on Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) as reported by Center for Monitoring Indian Economy (CMIE) database prowess during January 1, 2003 to December 31, 2008. There are multiple mergers in one announcement by the same company. 883 companies were involved in mergers of 1158 target companies.

There are 86 announcements of mergers by companies in financial sector. The companies in financial sector are governed by different set of regulations. Therefore, such mergers have been excluded from study. Their exclusion has left us with mergers of 1,072 targets companies by 687 acquirer companies. Table 1 presents the year-wise trend of announcements of merger by nonfinancial companies. For credence, the details of these mergers were checked from the archives of corporate announcements available of the website of Bombay Stock Exchange and National Stock Exchange. We verified the type of targets, status of the mergers/ amalgamation, High Court approval date, record date and method of payment from the individual corporate announcements and annual reports of the companies. We checked the year-wise status of mergers/ amalgamations during the period.

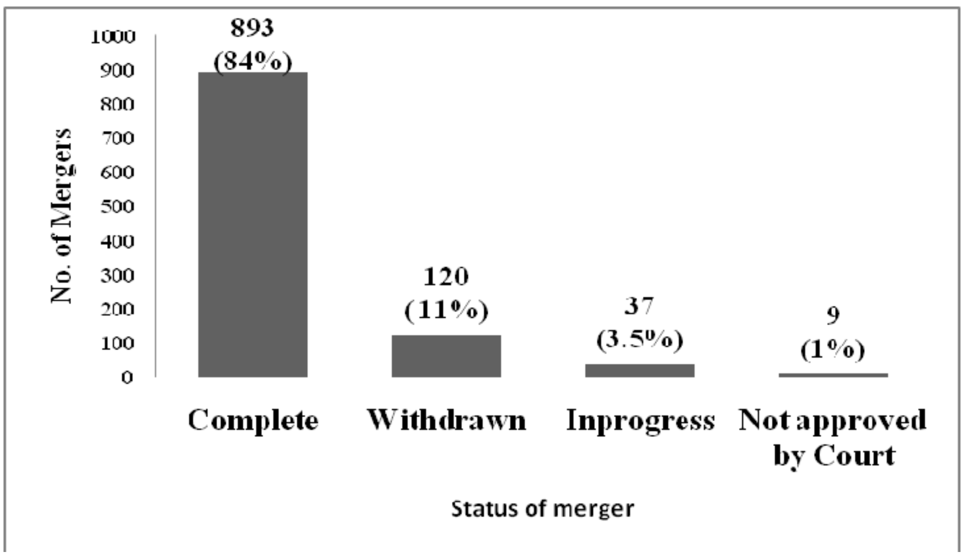
We observe that nearly 10 per cent of mergers initiated during 2006-08 are still pending for court approval. There is a need to expedite the process to approve these mergers, so that corporate can timely realize the synergies.

Table 1. Number of corporate mergers announced by non -financial listed companies, 2003-08

Year	No. of mergers	No. of acquired Co. involved in mergers
2003	123 (11.5%)	81 (11.7%)
2004	124 (11.6%)	86 (12.5%)
2005	199 (18.6%)	118 (17.2%)
2006	253 (23.6%)	159 (23.1%)
2007	216 (20.1%)	134 (19.5%)
2008	157 (14.6%)	109 (15.9%)
Total	1,072(100%)	687 (100%)

Source: CMIE database Prowess.

Figure 1 depicts that 893 mergers have been completed during 2003-08.



Source: Compiled from various sources

Figure 1. Status of mergers announced by listed companies, 2003-08

Table 2 summarizes the characteristics of companies by number of mergers. Nearly threefifth (59%) of the companies (involved in merger activities) has merged one target company. Onethird (34%) companies (involved in merger activities) have merged two to four companies. Only two per cent of the companies have been involved in merger of 8 or more companies.

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Table 2. Frequency distribution of number of companies merged by a corporate, 2003-08

No. of Mergers	N	Percentages
1	335	59
2-4	194	34
5-7	29	5
8-10	6	1.1
11-15	3	.7
Above 15	1	.2
Total	568	100

Source: Compiled from various sources

Table 3 exhibits the types of targets of completed mergers during the period. It is evident from the table that more than two fifth (44%) of the merged companies are public limited unlisted companies while around one fifth (16%) are public limited listed companies. Two-fifth (40%) target companies are private limited companies.

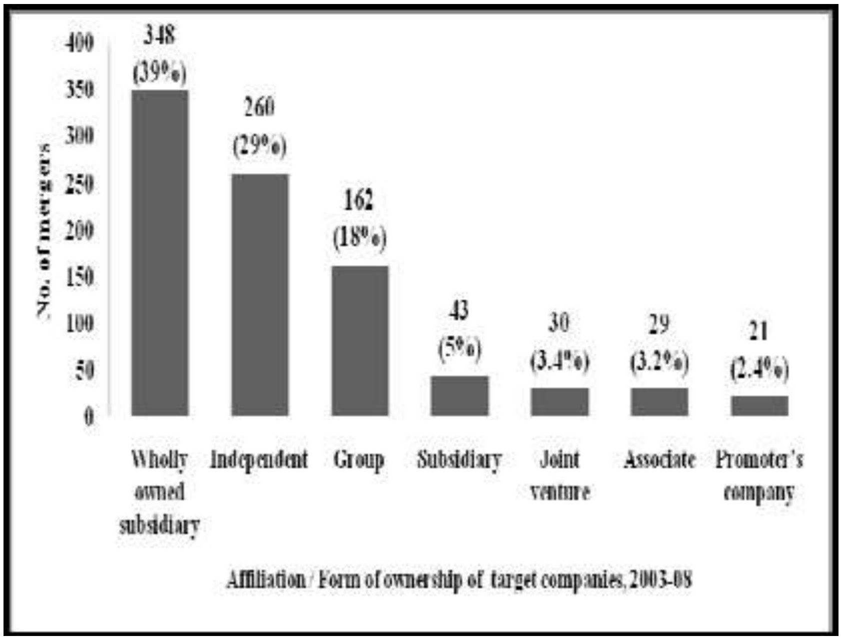
Table 3. Distribution of mergers completed by types of targets merged

Year	Public Limited Companies		Private Limited Co.	Total
	Listed	Unlisted		
2003	23	51	32	106
2004	23	57	20	102*
2005	42	92	65	199
2006	28	76	91	195
2007	19	67	90	176
2008	12	46	56	115*
Total	147 (16%)	389 (44%)	354 (40%)	893* (100%)

* There are 3 reverse mergers.

Source: Compiled from various sources

Figure 2 reveals the trend and characteristics of target companies and their relation with the acquirers. The figure shows that only 29 per cent mergers have taken place between independent companies during 2003-08. Mergers landscape is dominated by mergers of wholly owned subsidiaries up to the extent of 39 per cent. It has been observed that majority of the mergers during the period is between subsidiaries and the group companies.



Source: Compiled from various sources

Figure 2. Affiliation/form of ownership of target Co. merged, 2003-08

The manufacturing sector and the service sector accounts for 76 per cent and 24 per cent mergers respectively during 2003-08. Metal and metal products in manufacturing sector has been observed to have the highest number of mergers followed by chemical, drugs and pharmaceuticals. It has been observed during survey that steel industry has seen restructuring during 2003-08. The motive of merger for this industry has been integration both backward and forward. IT sector has witnessed the highest percentage (38%) of mergers followed by trading sector. In services sector, nearly half of the mergers (50%) are during 2006-07. The period 2005-07 has witnessed the peak of mergers in IT sector.

IV. Research Design

The research design consists of survey instrument, sample selection and limitations 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 parent company during sample period?

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, 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 hypotheses prevalent in the area of mergers and acquisitions. We limit the scope to the amalgamations only.

V. Empirical results

We present 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: Respondents' profile

Respondents Designation	Number (percentage)
Chairman, Executive Directors (Finance) and Chief Financial Officers	49 (32.30%)
Vice Presidents, Head and Chief Legal Officers	35 (23%)
Company Secretary and Deputy General Manager	38 (25%)
General Manager(Finance, Investor Relations)	30 (19.70%)
Total	152 (100%)

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.

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

Number of Mergers	N	Per cent
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.

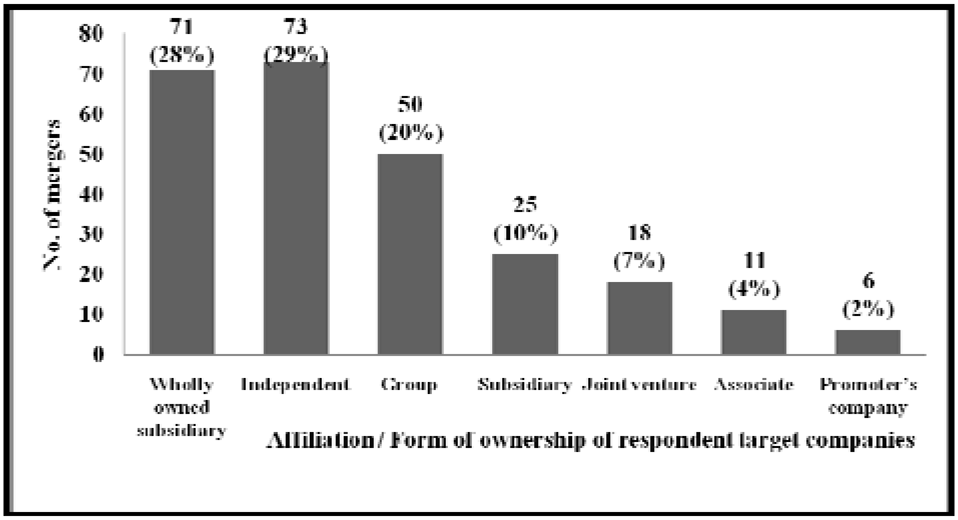


Figure 3. Affiliation/form of ownership of respondent target Co. merged, 2003-08

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 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 advantage 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 =

[{(Prime Motive × 3) + (Second Motive × 2) + (Third Motive × 1)} ÷6]

Table 7 presents 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. We attempted to investigate the motive of mergers/ amalgamation of merger of wholly owned subsidiaries. Table 8 describes the results. The respondents revealed that the primary motive has been a composite scheme of arrangement for consolidation. Another important reason has been a response to the changes in regulatory framework. The results are in agreement with other studies Jarrell 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 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 economies	26	19	10	21	1
4	Increased market power	12	10	17	12.2	2
1	Financial economies	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 economies	1	2	7	2.3	8

Note: The weighted score = [{(Prime Motive × 3) + (Second Motive × 2) + (Third Motive × 1)} ÷ 6]

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

Motive no.	Motives 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 = [{(Prime Motive × 3) + (Second Motive × 2) + (Third Motive × 1)} ÷ 6]

Parent-subsidiary mergers have not been widely investigated in the finance literature, but have implications for corporate governance. It has been observed that regulations related to corporate governance has evolved during 2003. Securities and Exchange Board of India (SEBI) monitors and regulates corporate governance of listed companies in India through Clause 49. This clause is incorporated in the listing agreement of stock exchanges with companies. It is compulsory for all listed companies to comply with the provisions of SEBI clause 49. Various clauses of listing agreement have been amended during 2001-2005. Some of the new provisions regarding disclosure requirements of unlisted subsidiaries under listing agreement are;

a) SEBI has amended clause 32 and Clause 41 of Listing Agreement, In lieu of the amended clause, "a listed parent company is now mandatorily required to publish audited Consolidated Financial Statements in the annual report in addition to the separate financial statements."
b) SEBI has revised Clause 49 of the Listing Agreement related to corporate governance. The major new provisions included in the revised Clause 49 regarding subsidiaries are:

i. "At least one independent director of the holding company to be a director in material non-listed subsidiary company.
ii. The audit committee of the listed company shall review the financial statements of the unlisted subsidiary, in particular, the investments made by the unlisted subsidiary company.
iii. The minutes of the Board meetings of the unlisted subsidiary company shall be placed at the Board meeting of the listed holding company. 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.

VII. Conclusions 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 mergers 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.

Notes

i. Synergy is the ability of a corporate combination to be more valuable than the individual companies that were combined. Exiting literature identifies operating, financial and managerial as three main forms of synergies.

ii. CMIE Mergers and Acquisitions, Prowess, Venture Intelligence M &A Deal Database, Capitaline, Annual Reports of Companies, Website of Bombay Stock Exchange (BSE) and National Stock Exchange(NSE)

iii. vide a notification SMDRP/Policy/Cir-44 /01, dated 31 August, 2001 available at http://www.sebi.gov.in/circulars/2001/CIR442001.htm l

iv. vide a notification SMD/Policy/Cir-2 /2003 dated January 10, 2003 available at http://www.sebi.gov.in/circulars/2003/cir02- 2003.html

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v. vide circular SEBI/CFD/DIL/CG/1/2004/12/10 dated October 29, 2004 available at http://web.sebi.gov.in/circulars/2004/cfdcir0104.pdf

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