CHAPTER 10

CONCLUSION

The phenomenon of a pronounced rise in the number of merger and TO announcements (realised and abortive) in India since the 'neoliberal reforms' (Bagchi (1999: 16)) of the 1990s, initially kindled our interest in the research on the behaviour of such contemporary corporate consolidations in the country. This interest has taken a shape in the present study. We do not claim to have analysed all the aspects of mergers and TOs in India. The main thrust of this thesis is to trace the nature and causes of the mergers and TOs in India in the post-liberalization regime and in the process to highlight some of the economic consequences of such corporate restructuring in the Indian situation on the basis of a sample of Indian firms. However, this study has raised various pertinent issues and our approach and findings must give pause for thought. Section 10.1 lists some of the major findings of this study. Section 10.2 brings out the policy implications. Section 10.3 discusses the limitations of the analysis and the scope of further research.

10.1 Principal Findings

We began this study by raising a number of questions that reflected our analytical interest in the nature, composition, causes and effects of mergers and TOs in India in the 1990s. How do we conceptualise mergers and TOs in the Indian context? What constitutes the driving force behind the contemporary merger and acquisition activities in India? What are the effects of these mergers and TOs in terms of market concentration and corporate size, profitability, etc.? How far are these mergers sustainable? Through these and a number of other questions we have attempted to analyse various aspects of contemporary mergers and TOs in India. The answers to these questions have been sought in the respective chapters. The principal findings that have been derived on the basis of our sample and sub-samples of merger and acquisition cases in the manufacturing sector in India over 1994 to 1998 are:

- The mergers that we have considered here are classified into in-group and inter-group mergers. The TOs are classified as TOs in the form of change of stake, TOs in the form of change of assets and TOs in the form of outright sale of companies. There are also some TOs in the form of open offers that are recorded but we have only mentioned them and not included them in our sample because they had not materialised over the relevant period of study.
• In our sample of 550 mergers and TOs, there were 37 cases of acquisitions of sick companies by healthy companies under the auspices of BIFR. There were also 6 reverse integrations of healthy companies with sick companies.

• The 550 mergers and acquisitions have been drawn from 41 product classifications of which 15 product groups experienced a significantly large number of corporate consolidations over 1994 to 1998. All the analysis have been confined to these 15 product categories.

• Of these 550 mergers and TOs in the manufacturing sector, 384 have been horizontal. A large number of horizontal mergers are feared to increase market concentration in the economy, especially in the absence of regulation of monopolistic practices since the dismantling of the MRTP regulations in 1991. This has its own anti-trust implications in terms of affecting level of industry concentration, which we have discussed in Chapter 8.

• Out of the mergers and TOs in our sample, 237 acquisitions were those of Indian companies by foreign firms. This raises concern for the domestic firms from various perspectives, some of which are: the disparity in size between foreign affiliates and domestic firms; the greater production efficiency or sales capability of foreign affiliates (which can lead to the exit of domestic enterprises that have yet to build up the necessary capabilities to withstand international competition, or to their merger with foreign firms); the use of modes of competition that are new to the Indian markets; the introduction of new products for which no other local producers or substitutes are available, etc.

• There were also 16 acquisitions of foreign companies by Indian firms. Although quantitatively insignificant, it marks the role played by Indian firms in the globalisation process.

• We could obtain pre-merger data on average net sales on 50 cases of merger and TO activities in India over 1994 to 1998, out of which in 43 cases we found the acquiring company to have higher pre-merger sales. If net sales is taken as an index of size, then, in general, the acquiring firms are found to be larger in size than the corresponding targets.

• Although the acquiring firms have revealed to have greater size in terms of net sales than the corresponding acquired companies in majority of the cases, it becomes evident from the analysis that the acquiring companies are in India in general not of substantially large size. Those which are of medium size are the big Indian companies. The large sized companies figuring out in our sample are the MNCs.

• We could obtain pre-merger data on average net worth on 52 cases of merger and TO activities in India over 1994 to 1998, out of which 47 cases, i.e., for 90.39% of cases, the acquiring companies have higher pre-merger average worth. If net worth is taken as an index of owner's contribution to the capital of the company, then, in general, the shareholders of acquiring firms are found to have relatively
larger contribution to capital than the corresponding targets. However, our analysis reveals that the proportion of firms with very small net worth is higher among the acquired companies. In contrast, the acquiring companies are mainly of small to medium net worth as per our classification.

- Pre-merger data on average gearing ratio was available for 38 cases of merger and TO activities in our sample. Pre-merger average gearing ratio comes out to be higher for acquiring companies in 13 cases. For the remaining 26 cases, i.e., for 68.42% of cases, the acquired companies have higher pre-merger average gearing ratio. If gearing ratio is taken as an index of debt burden of the company, then, in general, the acquired firms are found to have larger debt liability before consolidation than the corresponding bidders. High gearing is attractive to firms because the associated interest payments are tax-deductible. However gearing is inversely related to the change in the price of stocks. Thus high gearing ratio would mean that the firm is undervalued and this would make it a potential target. This partly explains why the target firms with high gearing ratios may actually become the ‘targets’ of acquisitions in India.

- Pre-merger data on average operating profit could be available only for 25 cases out of which the acquiring companies have higher pre-merger profitability for 18 cases, i.e., for 72% of cases. If operating profit margin is taken as an index of efficiency of the company, then, in general, the acquiring firms are found to be more efficient than the corresponding targets.

- If we compare size (net sales) with profitability (operating profit margin) in our sample of 20 cases of consolidations for which data was available on both the variables we see that in 13 cases both size and profitability are higher for acquiring companies. This contradicts Singh’s hypothesis and indicates that for these cases the acquiring firms are not necessarily potentially predatory, taking over smaller, more efficient firms. Rather it percolates that bigger and more efficient firms acquire smaller and less efficient ones. Singh’s hypothesis is however affirmed in the remaining seven cases. Although this sample size is far too small to make any strong assertion yet it provides us with an interesting result that can be examined on a larger sample base.

- Apart from the economic and the apparently non-economic factors that played a significant role in promoting mergers and TOs in India in the 1990s, the changes brought about through the NIP in terms of increased securitisation, greater openness and also the policy changes with respect to domestic production and the role of the public sector, gave a boost to the merger and TO activities in India after 1991.
• We have examined the extent of concentration in the manufacturing sector in India in the 15 product groups over the six years from 1993 to 1998. We have adopted the MRTP notion of dominance whereby a market share exceeding 33% until 1982 and exceeding 25% since then, is considered to be an indicator of concentration of market power. We have taken 25% as the cut-off point. We have observed that in 11 out of 15 product groups the level of market concentration was found to be high, out of which in 10 sectors concentration is ‘consistently high’ (micro-level concentration, CRm greater than or equal to 25% in at least five out of six years) over the relevant period. It is moderate (CRm greater than or equal to 25% in three out of six years) in one sector and low (CRm greater than or equal to 25% up to two out of six years and also CRm consistently less than 25%) only in the remaining three. The product-wise annual concentration ratios demonstrated a rising trend in 8 of the 15 product classifications. It was zero in the automobile sector and falling in the remaining six sectors. Thus we observe not only high concentration ratios for most the different product groups studied in this thesis, but also a trend towards rising concentration ratios in a substantial number product categories. Also, a moderate yet rising trend is observed for the concentration ratio at the macro level (CRM). This general trend of high and rising concentration ratios in product groups with mergers and acquisitions is an indicator of concentration of economic power and the play of anti-competitive and restrictive practices. This seems to have disturbing policy implications especially in respect to the repeal of certain sections and provisions (anti-trust laws etc.) of the MRTP Act whereby mergers and TOs are no longer required to seek prior permission of the MRTP Commission under the MRTP (Amendment) Act, 1991.

• In the quest for a deeper idea on post-merger performance of acquiring firms, we have also compared the pre-merger and post-merger size, net worth, gearing ratio and profitability of a number of acquiring firms. For this, our sample set comprised 18 acquiring companies. Post-merger average net sales (i.e., size) rose for 17 of these firms.

• Average Net worth increased for 14 out of the 18 acquiring companies. A rise in the post merger net worth indicated that the paid up capital plus reserves increased for these companies. This indicates a rise in the shareholders’ contribution to the capital of the company after merger in the absolute sense.

• Out of the 15 consolidations for which data is available for gearing ratios of acquiring companies, it is rising in the post-merger situation for 9 acquiring companies. This independently indicates increasing debt-dependence for these companies with merger.

• However, equity participation in the capital structure of a company needs to be seen in conjunction with the debt dependence in the capital structure. If we combine our findings regarding the movement of magnitudes of net worth and gearing ratios for the acquiring firms 'post-merger, we can not trace unambiguously what the definite trend was, regarding the external financing pattern of the acquiring firms.
• Of the 14 acquiring firms for which we could obtain post-merger data on operating profit margin, 8 (57.14%) showed a decline after merger. In general, the fall in profitability immediately after a merger or TO can be rationalised by attributing this fall to various adjustment lags and cost rises associated with merger activities and by hoping that this fall would be reversed after reasonable time period when all adjustments have been made. But at the same time it may also raise doubts regarding the sustainability of those mergers in particular and merger and TO activities in general, in our economy, at least, at this point of time. At this juncture, various queries regarding the prevailing CG structure of the country may emerge.

10.2 Economic Impact of Mergers and Takeovers in India and Associated Policy Implications

The Indian economic organization has been subject to changes under the impact of greater Indian involvement in the international economy particularly after the economic reforms programme initiated by the government in July 1991. The economic liberalization in 1991 and the adoption of the NIP and associated measures, involved structural policy changes in relation to the industrial sector, the trade regime, foreign investment, foreign technology, the public sector and the financial sector in the form of trade liberalization, direct foreign investment (DFI) liberalization and domestic deregulation. In such an economic regime, corporate restructuring in the form of mergers and TOs proliferated.

On the basis of our sample mentioned above, we have identified several effects of merger and acquisition activities in India over the period 1994 to 1996 on the economy, of which two deserve special mention. On the one hand, such activities increased market concentration in a significant number of product groups. Concentration of economic power is considered to reduce economic welfare of the country through encouraging anti-competitive and monopolistic practices in certain industries and in a general level, in the manufacturing sector as a whole. On the other hand, the contemporary mergers and TOs reduced the post-merger profitability of a number of merged firms and in this sense made the merger activities appear to be unsustainable. Both the effects impose costs to the economy. The second type of cost can theoretically be minimised through proper governance of corporates that would ensure internal control of firms. This takes us to the notion of CG in the context of mergers and TOs. However, when it comes to the concentration aspect of mergers, the question becomes whether the evolution of CG principles in terms of an active market for corporate control would be conducive to Indian industrialisation and economic growth. In fact, evidence surveyed in this study from advanced countries suggests that the end result of this whole process of CG based on capital market dominance and a free market for corporate control may not always be better and could sometimes be considerably worse. Here emerges a question of choice between the A-A system of CG based on a free and active market of corporate control and the Japanese (and German) "relationship-based" system characterised by less liquid
capital markets, relatively inactive TO market and the existence of other disciplining devices, than the stock-market, in which workers are given a voice in running the firm and in strategic decisions that affect their own future, in designing a code of CG for India.

We have seen in our thesis that the policy recommendations regarding the guidelines for CG in India both at the government level and also at industry level seem to have taken a liberal view towards TOs, subscribing in the process to the A-A theory of CG where TOs are thought to play an important role in building corporate synergy, in raising shareholder value and in keeping companies on their toes. There is a need to review these recommendations and take into account the various types of costs that come up with mergers and TOs. Apart from the two costs that we have empirically identified in the Indian context, there are certain other costs that emanate when we adopt a scheme of CG that is based on capital market dominance and mergers and TOs as the major disciplining device. Some of these costs are short-termism, lack of post-merger cultural integration, improper identification of stakeholders, unfavourable redistribution of wealth, etc. These are some of the issues that are to be thoroughly dealt with, to arrive at some well-defined code for CG in India and the effective role of mergers and TOs therein.

Though various recommendations on an appropriate code of CG are being made in India from different interest groups, no well-defined structure has emerged till now. Given the costs and inefficiencies associated with mergers and TOs, the policy prescription at this juncture would be that the government should seek to formulate a code of CG that would try to solve governance problems in ways other than the system of management change that TOs represent, given the high costs that TOs involve. In this connection, the paradigms of CG of Japan and Germany seem to be well-suited than the Anglo-American structure.

10.3 Limitations of the Analysis and Scope of Further Research

Limitations
The study of the behaviour of mergers and TOs in the Indian manufacturing sector in the post-liberalization era involves a multiplicity of issues, the scope of which is infinite and what we have touched upon is only the tip of an iceberg. Full justice to the possibilities would merit a voluminous work on the subject. We have, however, limited our analysis to only the nature, causes, consequences and policy implications of merger and acquisition activities in our economy in the liberalized era, in the backdrop of the merger and TO policies in India. In each area that we have discussed, many more questions can be asked. As such, much still remains to be done to obtain a more complete picture of the scenario of mergers and TOs in the Indian situation.

The basic problem that we have undergone is with respect to the nature of the data that is available. This is the area in which much more work needs to be done, at the firm, plant and industry level. The firm level data has to be acquired from business journals, which are not sometimes mutually comparable, because they use different
definitions and industrial classifications. In addition, little information is available on certain variables that are crucial to such studies. For example, we could not use certain variables like cash flow or book value to market price because they were not provided for all the years that we needed. Moreover, data on certain variables is not always available for the required number of years for each of the relevant companies. As such the time period becomes too restricted and/or the sample too small to carry out meaningful analysis. The risk of looking into different source materials for the time series data on a particular variable is that their calculations may vary.

Integrating and processing the data that is officially collected would strengthen the foundations of any industrial organisation research that is undertaken. The CMIE data-base is trying to resolve some of these problems. CMIE started publishing monthly data on mergers and TOs from September 1995. The domain of its scope in publishing corporate information at the firm level is being gradually expanded in recent years and hence much of past data (corporate data of late 1980s) that we require for a valid analysis are not available in CMIE sources.

Scope of further research
This study is basically analytical with the use of elementary statistics. In this study, we have identified certain broad patterns in the pre-merger as well as the post-merger behaviour of consolidating firms on the basis of the four selected variables, without going into the specific reasons behind the behaviour pattern of the firms at a case-by-case level. This could have made a more robust study of the characteristics of some of the target and bidder firms in India and enabled us in building up a self-contained study for several product classifications. We could not engage ourselves in such a project mainly for three reasons, all of which are equally important. First, we were more inclined to build a perspective of the institutional and economic environment of the country in the recent period where the contemporary consolidation activities are taking place. Secondly, we found that because of the lack of availability of financial data on all or a large chunk of the variables relevant for a detailed analysis of merger and acquisition cases, such study at the industry level could be limited. Thirdly, post-merger the time span was too short to make any predictions regarding the performance of the acquiring firms post-merger on a case-by-case basis. We intend to carry out such a firm-level study in future.

So far as the effects of mergers are considered we have quantified the extent of concentration due to mergers and the direction of post-merger profitability of the merged firms. The study can be extended by considering other factors that may influence performance of mergers like research and development, extent of foreign collaboration for the firms involved in mergers and acquisitions, etc. We can also make further studies that would compare post-merger performance of firms among various industries using sophisticated techniques like data envelopment analysis (Majumdar (1994)) which is a performance measurement tool useful for uncovering patterns of dynamic performance. Also, we can compare within an industry the performance of firms that entered into consolidations with firms that did not. However, such dynamic analysis to be really meaningful would require a reasonable span of time to elapse in the post-merger period so that we can make effective study of the impact of mergers and acquisitions on the performance of firms. We can
however, be optimistic to carry out such dynamic analysis for those mergers and TOs occurring in India in the post liberalization regime that would remain sustainable in the next century.

In the chapter on CG we have only addressed some of the basic initial issues that are to be taken care of in constructing an appropriate code for India. In further research it would be meaningful to make firm-specific intensive study of CG and to examine the role of CG in post-reform financial restructuring in India.

Finally, in our future research agenda, we propose to extend this study on merger and TO activities in India to comparisons with those in some of the other developing countries. Such an effort is expected to help policy-making considerably, both in India and in other economies, if the results obtained for the countries could be meaningfully compared.