Chapter I
Introduction and Design of Study
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INTRODUCTION AND DESIGN OF STUDY

LEAVING THE OLD, BOTH WORLDS AT ONCE THEY VIEW THAT STAND
UPON THE THRESHOLD OF THE NEW

- EDMOND WALLER

1.1 INTRODUCTION

Globalisation, rapidly improving technology, and a heightened focus on providing customer value have significantly increased competition in almost all the markets. Enterprises worldwide are facing the challenge to find the niches where they can add the greatest economic value. The never-before visualised dream of “growing big” into the competitive global market is shortly but surely materialising. Business houses are under pressure, as the “survival of the fittest” becomes the reality. A perceptible change in the business paradigm has been taking place the world over. The core competency is emerging as the new ‘mantra’ for growth of business houses. Companies are critically evaluating their core capabilities in order to reorganise themselves and to strive and surge ahead in this extremely competitive environment. Nothing is permanent in this temporal environment except ‘CHANGE’. Corporates in this changing environment have to rejuvenate themselves to take-on the challenges posed by this permanent feature of a corporate life namely ‘Change’. Mergers and Acquisitions (M&A) are one such rejuvenation capsule that corporates are willing to take.
M&A are the result of the unquenching thirst for growth and expansion coupled with the need to re-align a business unit to this changing environment. They have played an important role in the external growth of a number of leading companies the world over. In the US, the first merger wave occurred between 1890 and 1904 and the second wave began at the end of World War I and continued through the 1920s. The third merger wave commenced in the latter part of World War II and continued till late 1960s. The fourth wave was in the 1980s and the fifth wave started in 1990s and continues to the present day.

M&A, as they are understood in the western countries, have started taking place in India in the recent years. A number of mega mergers and hostile takeovers are being witnessed now. The Indian corporate sector has experienced a major restructuring through M&A, which are the result of Economic Reforms especially, the Industrial Policy Resolution of 1991. Earlier to 1991, M&A were activated with the main objective of availing tax benefits or due to a unit becoming ‘sick’ according to Board for Industrial and Financial Reconstruction (BIFR). In order to attain the accelerated growth at the micro and macro level of industrial activities, it became demanding to go in for M&A in India as was witnessed in the USA. That growth is vital for a firm’s survival is indisputable and M&A are the fastest route to growth. Mergers represent resource allocation and reallocation process in the economy, with firms responding to new investment and profit opportunities. Mergers, rather than internal growth, are more efficient in terms of resource utilisation.
1.2 MEANING OF THE TERMS ‘MERGER’ AND ‘ACQUISITION’

Merger is defined as combination of two or more companies into a single company, where one survives and the other loses its corporate existence. The survivor acquires the assets as well as liabilities of the merged company or companies. Generally, the surviving company is the buyer, which retains its identity, and the seller company is extinguished. Merger is also defined as acquisition. Merger is also the fusion of two or more existing companies. All assets, liabilities and stock of one company are transferred to the transferee company in consideration of payment in the form of equity shares of transferee Company or debentures or cash or a mix of the two or three modes. Thus, merger is also an amalgamation of two corporations pursuant to statutory provisions in which one of the corporations survives and the other disappears. Both ‘merger and ‘acquisition’ take place when the undertaking of more than one company are brought under the ownership and control of a single company which may be one of the companies involved or a new one. The result is that shareholders who were members of the several amalgamating companies now together own and control the same enterprises as one joint venture.

1.3 NEED FOR THE STUDY

Corporate India is facing hyper competition, both within the domestic market and also in its export markets. In the context of liberalisation and globalisation of the economy, the changes required in the functioning of corporates need to be vast. It becomes imperative for all the corporations to review their alignment of vision, values, strategy, skills, structure, systems, technologies and corporate work culture. In the light of review they need to
either re-enforce or restructure this alignment. M&A are the outcome of this review of their alignment, of their everlasting desire for growth and change.

In the post 1991 period, there has been a sharp increase in the total number of M&A in India. The corporate houses have well responded to the economic reforms, especially to the Industrial Policy Resolution of June 1991. From 1997 to first half of 2000 there has been a steady increase in the number of M&A and in the value of M&A both globally and in India. Globally from less than 17000 mergers in 1997 it shot upto almost 24000 mergers in 2000 and came down to less than 18000 mergers in 2002. In line with global trends, in India too, the number of M&A in 1997 was 73 and it shot upto 446 deals in 2000 and came down to almost 200 deals in 2002. In spite of a slight decline in the number of deals in recent years, M&A are continuing to be head-line-grabbing news and a major restructuring strategy of the corporates in this competitive environment. Hence, this study has been undertaken to understand as to what goads companies to go in for this particular restructuring strategy. Are the M&A really working? How well did corporate-acquirers fare with their catches? This study becomes all the more pertinent, as the value involved in the mergers taking place in recent times is a whopping 4000 million dollars. Hence there is a need to investigate as to whether these M & A activities, which involve huge sums of funds, are really working.
1.4 STATEMENT OF THE PROBLEM

In this hyper-competitive environment the necessity for change and creativity to achieve corporate excellence cannot be under-estimated. M&A are a means to this end. M&A help in the achievement of the strategic objectives of the acquirer. These strategic objectives may be varied, including growth of the firm, gaining competitive advantage in existing product markets, market or product extension, or risk reduction. Like all other strategic decisions, M&A should satisfy the criterion of added value. The outcome of M&A is of considerable interest to all the stakeholders in the merging firms. These include shareholders, managers, customers, employees and the entire society. The funds involved in M&A run into several millions and therefore, when corporate groups procure huge funds to adopt this growth-strategy the following questions arise:-

(a) Have M&A enhanced shareholder wealth? Has it led to value creation?
(b) Have M&A resulted in financial synergies?
(c) Have M&A led to operational synergies?
(d) Have M&A been initiated as a diversification strategy for risk pooling?

This study is aimed at providing answers to the above vital questions on creative restructuring and growth through M&A.
1.5 PERIOD OF STUDY

The study covers a period of ten years from 1992 to 2002. The decade of 1990s was chosen because it was during this decade there has been a spurt of M&A activities in India especially after the 1991 economic reforms which led to cut-throat competition and dynamic environmental activities. This dynamism led the corporates to search for appropriate restructuring activities to adapt to this dynamic environment. They found M&A to be the most effective strategy for corporate restructuring and accelerated growth.

1.6 OBJECTIVES OF THE STUDY

In recent years Mergers and Acquisitions have generated a lot of interest among analysts, among people involved in the activity as well as the general public. India, since 1991, has been witnessing a spate of economic and business-restructuring activities, thanks to the liberalisation and economic reforms introduced from 1991 onwards. The present study on M&A was undertaken with the following objectives:

(a) To analyse the pre and post-merger performance, both operational and financial of the acquiring firms to see if it led to synergies.
(b) To compare the post-merger performance of diversifying mergers with that of non-diversifying mergers to analyse which of the two performs better after merger.
(c) To evaluate if diversifying mergers have been used by firms for risk-pooling and;
(d) To examine if M&A have led to value addition and thereby increased productivity for the acquiring firms in the post-merger period as compared to pre-merger period.

(e) To recapitulate key findings and draw conclusions.

1.7 METHODOLOGY

Sample size - As already mentioned, the period between 1992 and 2002 was chosen. During this period there was a spurt of M&A activities especially after the 1991 Economic Reforms. 213 M&A that had taken place during this period according to Capitaline-ole database were identified. Out of this only 48 acquired firms and a matching number of 48 acquiring firms had data for at least three years prior and three years after merger. Thus, the sample size was brought down to 96 firms (48 acquiring and 48 acquired firms). Capitaline-ole database was used as the basis for selecting the sample.

Collection of Data - In all 48 mergers was selected. Having selected the cases, adequate attention was paid to the collection of data, which depended upon the purpose of evaluation of merger. This study used secondary data only.

Capital market database called Capitaline-ole was used for obtaining financial information about the merged firms. Internet sites were used for obtaining additional general information on M&A activity in the world over. The annual published financial reports of the companies have been used for random check-up of data. The Stock Exchange Official Directory, Mumbai
and Kothari’s Industrial Directory of India have also been used to supplement the data.

1.8 ANALYSIS OF DATA

Having collected necessary information, the researcher decided to analyse the data for each of the 48 mergers and acquisitions in the following order.

Objective-I: To analyse the pre and post merger performance both operational and financial of the acquiring firms to see if it led to synergies.

To achieve the above objective the following parameters were analysed:

(a) Pre-merger and post merger operating return on net assets.
(b) Weighted Average operating return on net assets.
(c) Average growth in total assets.
(d) Leverage ratios.
(e) Ratio of tax provision on operating profits.
(f) Liquidity ratios.

To test the difference in medians of the pre-merger characteristics of the acquired and acquiring companies, Wilcoxon Rank Sum Test was used. In all cases, the t-test at two tailed statistical significance levels was applied for the variables, since it was unclear ‘a priori’ whether the difference would be positive or negative for the profits and other factors. Wilcoxon Rank
Sum Test is a non-parametric test of differences between the pairs of observations in the paired-sample case.

**Objective-II:** To compare the post-merger performance of diversifying mergers with that of mergers taking place in the same industry to analyse which of the two perform better after merger. For achieving this objective various parameters like profitability, liquidity and solvency were studied. Appropriate statistical tools were also used for further analysis. Discriminant Function Analysis was used to test if there were any significant differences in the selected financial parameters between diversified and non-diversified Mergers & Acquisitions. An attempt was also made to use Logistic Regression Technique to predict the probability of a firm going in for a diversified merger as against non-diversified merger using selected financial parameters.

**Objective-III:** Identifying the diversifying mergers and to study if risk pooling was the main rationale for such mergers. The approach adopted involved a simulating procedure using the pre-merger data only. Thus, the pre-merger profitability of firms which subsequently merged was compared with the profit series which would have been generated had the merger already occurred. The risk pooling effects in two samples of mergers (one for all mergers and two for diversifying mergers a subset of the former) were tested by this method. The average variability of profits was calculated for three groups of firms in each sample as below:

- (a) The acquiring firms.
- (b) The firms with higher pre-merger variability of profits and
(c) The simulated merged firms. A t-test was applied to test the differences in mean variability of profit among the three groups.

**Objective-IV:** To examine if M&A have led to value addition and therefore, increased productivity for the acquiring firms in the post-merger as compared to the pre-merger period. The model developed by Grange Moore has been used to achieve this objective and the following ratios were calculated:-

(a) Value added/Capital employed.
(b) Value added/Operating assets.
(c) Value added/Cost of capital consumed.
(d) Operating Profit/Value added.
(e) Value added/Sales.
(f) Value added/Payroll costs.

Common statistical tools like Percentage, Arithmetic mean, Standard Deviation and Co-efficient of Variation have also been used in the study,

1.9 **HYPOTHESES OF THE STUDY**

The following hypotheses were framed for the present study: -

i) M&A do not result in operational and financial synergy.
ii) Diversifying M&A do not result in risk pooling.
iii) The financial characteristics of diversified and non-diversified M & A do not differ significantly.
iv) M&A and value addition are independent of each other.
1.10 LIMITATIONS OF THE STUDY

The effect of inflation not considered in the present study.

The financial statements from which data have been extracted are historical and quantitative in nature. Hence, the study incorporates all the limitations inherent in such statements.

1.11 ORGANISATION OF THE STUDY

This study has been organised as follows:-
Chapter 1 – deals with introduction and design of study
Chapter 2 – deals with review of literature
Chapter 3 – traces the history of M&A activities in India and abroad.
Chapter 4 – analyses the effect of M&A on profitability, liquidity and growth of firms.
Chapter 5 – analyses the effect of diversified mergers on risk pooling.
Chapter 6 – deals with value addition, measurement of productivity and M&A.
Chapter 7 – recapitulates the findings of the study and draws conclusion.