CHAPTER - 3
LITERATURE REVIEW

In India, the issue of corporate Mergers and Acquisitions (M & A) has attracted attention from academics, government, and capital markets in the wake of structural adjustments and globalization policy pursued by the government. This chapter presents, briefly, the review of studies carried out by different researchers in different settings to understand as to what stimulates corporate managements to indulge in takeover exercise.

3.1. Introduction:

In the first two months of 2012, M & A transactions amounting to $16.06 billion have been announced and likely to observe a host of M & A transactions\(^4\). The total value of inbound deals, (wherein foreign companies or their subsidiaries acquired Indian businesses) in February 2012 was $270 million by way of 9 deals as compared to $7.45 billion in the corresponding period in February 2011 via 8 transactions. The total value of outbound deals (Indian companies acquiring companies outside India) in February 2012 was $441 million (5 deals) as against $206 million (11 deals) in February 2011. These deals estimated to be of value over $12 billion. According to Dealogic data\(^5\), in 2012 it has taken a longer time to reach the $1 trillion mark as it took 145 days (28\(^{th}\) May 2012) to reach the psychological mark, while in 2011 it reached $1 trillion in just 118 days (28\(^{th}\) April 2011).

\(^4\) Mostly on account of Vendanta group (Sterlite Industries, Sesa Goa and Vedanta Resources announced merger of Sesa Goa and Sterlite and the proposed consolidation of group structure). The latest announcement is that of acquisition by Bain Capital of 30% stake in Genpact for $1 billion (ET, A’bad August 3\(^{rd}\) 2012)

The cumulative value of M & A transactions globally during the five months of 2012 stood at $1.07 trillion, down 19 per cent from $1.32 trillion in the same period in 2011. A sector-wise analysis reported that in 2012, Oil and Gas was the most targeted sector as it attracted transaction worth of $139.7 billion, followed by Real Estate which cornered $110.2 billion and technology came in the third place with transactions valued at $98.5 billion. The M & A are witnessing moderation due to the international economic concerns, mainly around Europe.

3.2. Analysis of Literature:

Entering into a new market is a convoluted decision which must be given mission, vision and attention. By and large the objective of establishing a new business that would be acknowledged and supported by consumers, more and more business entrepreneurs are trying to enter quickly into the new market. There are different purposes for market entry. One of the motivational aspects to enter a worldwide market is the opportunity given by M & A deal to make the company more competitive. When a company becomes a multinational company, there is belief that such company has been competent to establish a competitive position in the open market not only in domestic but mainly in the worldwide arena. The literature review has been classified into different themes as objective of acquisition, strategy, market for M & A, synergy, wealth maximization, and reverse mergers of M & A and the studies conducted in each of the themes are reviewed and presented by keeping the objectives of the study in mind.
• **Objective of M & A:**

The companies are coming together hoping to gain a greater market share or achieve greater efficiency. Because of these potential benefits, target companies will often agree to be purchased when they know they cannot survive alone. Some popular objectives include synergy, tax considerations, diversification, management incentives, purchase of assets below their replacement cost, and breakup value. Separation of ownership and control may yield specialization advantage through the separation of risk-bearing and operating functions; it also introduced the possibility of conflicting objectives on the part of owners and managers (Jensen & Meckling, 1976). Managers prefer to increase the company’s size and scope while owners prefer to optimize their equity value (Marris, 1964). Opportunistic behaviour on the part of manager was predicted by agency theory, which characterized the firm as a nexus of contracts between principals and agents. Although unrelated diversification rapidly increased the size and scope of the acquiring companies, conglomerate mergers didn’t usually provide performance benefits to the acquiring companies.

Randall, Shleifer and Robert (1990) conducted study to find out which acquisitions are bad investments for bidding shareholders and determine whether those acquisitions appear to provide private benefits to bidding managers for a sample of 326 US acquisitions during the period of 1975 to 1987. Acquisition strategies focused on two aspects that can be readily understood in terms of managerial objectives; buying growth and diversification. It also looked at the relationship between bidder’s past performance and their returns from acquisitions. They concluded that the
market penalizes unrelated diversification much more heavily in the 1980’s than in the 1970’s coinciding with the rise of hostile takeovers. The negative return to acquisitions by poorly performing acquirers was evidenced that bad acquisitions were a manifestation of agency problems in the company.

Berkovitch and Narayanan (1993) conducted investigation to distinguish among the three major motives for takeovers; synergy, agency and hubris. Unlike other researchers, they distinguish among these motives by using correlation among target, acquirer, and total gains. They showed that positive correlation indicates the synergy and negative correlation implies agency being motive while hubris hypothesis results in zero correlation. Synergy was the reason for the majority of the takeovers; though with evidence that many takeovers were motivated by agency and hubris. However, agency, not hubris, seems to be the major reason for the existence of value reducing acquisitions. In takeovers with negative total gains, the total gains decreased with competition. This implies that, competition was motivated by agency rather than by true synergy and that competition will not eliminate agency problems when they exist but only aggravates them.

Several empirical studies lend support to the importance of synergy as M & A objective. Bradley, Desai, and Kim (1988) verified that a successful tender offer increases the combined value of the target and acquiring companies by an average of 7.4%. Eun, Kolodny, and Scheraga (1996) verified the synergy hypothesis for cross-border M & A using a sample of overseas acquisitions of the U.S.A companies during the period 1979-1990. Their results indicate that cross-border takeovers are normally synergy creating movements. Maquieira, Meggison, and Nail (1998) studied 260
absolute stock-for-stock mergers from 1963 to 1996. They verified substantial net synergistic profits in non-conglomerate mergers and by and large insignificant net profits in conglomerate mergers. Mulherin and Boone (2000) studied the acquisition and divestiture activity of a sample of 1305 companies’ from 59 industries during the period 1990-1999. The symmetric, encouraging wealth effects for M & A are consistent with a synergistic description for both forms of reformation. Seth, Song, and Pettit (2000) concluded that the synergy hypothesis is the prevalent explanation for their sample of overseas acquisitions of the U.S.A companies. Grinblatt and Titman (2002) also analyzed financial and operating synergies as the primary motivation for M & A during the 1990s.

Kee-Hong, Jun-Koo, And Jin-Mo (2002) conducted study to look at two competing views about business groups in emerging markets i.e. the value-added view and the tunneling view. In maximum business group, ownership was extremely concentrated and controlling shareholders have power over companies that surpass their cash flow rights. Porta, Lopez-de-Silanes and Shleifer (1999) concluded that “the central agency problem in large corporations around the world is that of restricting expropriation of minority shareholders by controlling shareholder”. This issue of organization between controlling and minority shareholders was very serious when there were few state sponsored mechanisms to protect minority investors and control the unrestricted power of large shareholders. Chaebol6 bidders that showed good past performance prior to merger realize significant negative announcement returns. Kim and Singal (2000) showed that major capital controls change in Korea occurred in 1992, when the Korean government opened the stock market to foreign investment.

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6Korean companies belong to a large business groups known as chaebol
The manager’s objectives were to expand the company’s size only to increase the resources under his control (Jensen, 1986), then it would expect a more negative market reaction to mergers involving larger targets. Horizontal and vertical mergers showed positive and significant abnormal returns. Companies that have their stock listed on foreign stock markets made better investment decisions than companies that are listed only on the KSE. The results showed that only the coefficient of the interaction variable for the top 30 chaebols were significant but negative at the 5% level. However, the underlying grounds were differing from one merger or acquisition to another. Brigham and Ehrhardt (2002, p. 970) stated, “the primary motivation for most mergers is to increase the value of the combined enterprise.” On the other hand, practical evidence never reveals whether M & A, on average, create value. Synergistic conclusions are the result from several sources including differential efficiency, operating economies, tax effects, financial economies, and increased market power (Flack and Lynch, 1999).

**Strategy:**

The word strategy is derived from the Greek word “strategia” which was used first around 400 B.C. This connotes the art and science of directing military forces to achieve a specified goal. According to Kenneth Andrews (1971) strategy is “The pattern of objectives, purpose, goals and the major policies and plans for achieving these goals stated in such a way so as to define what business the company is in or is to be and the kind of company it is or is to be” (p.28). In the present day competitive environment, no business organization can dream of survival without formulating appropriate corporate strategy. As the environment is continuously changing, the need for corporate
strategic framework need no over emphasis. The major components of corporate strategy are purpose and objectives, competitive advantage, synergy, personal values, aspirations and social obligations. Basically, strategy is the managerial response to turbulence.

Joseph (2001) tried to link strategic intent to the implications of integration that result. The thousands of deals that academics, consultants, and businessman lump together as M & A actually represent very different strategic activities. All M & A occur for either to deal with over-capacity through consolidation in mature industries; to roll-up competitors in geographically fragmented industries; to extend into new products or markets; as a substitute for R&D; or to exploit eroding industry boundaries by inventing an industry.

Hagedoorn and Duysters (2002) examined that companies have used alternative (quasi) external sources of innovative competencies such as strategic technology alliances, M & A, or combination of these. These alternatives are reviewed in the context of distinct industrial, technological, and international arrangements during the 1990. The history of companies, in terms of routines with a preference for M & As, strategic technology alliances, or a mix, determines their current preference for each of these modes or a combination of them for acquiring innovative capabilities. A group of 135 large US, Canadian and European companies were included in sample.

The finding of the study supported contributions from a variety of theoretical approaches such as those that combine elements of evolutionary economic theory with an understanding of the effects of strategic behaviour,
theories developed from an organizational learning and technology perspective, and work done in the context of institutional organization theory that pays attention to the impact of Industrial conditions on alternative forms of organization. It also found that these options (strategic technology alliances, M & A, or combination of these) are influenced by both different Industrial conditions and company specific circumstances, such as those related to protecting core business activities.

Mantravadi and Reddy (2007) tried to analysis the impact of different types of mergers on the operating performance of M & A in India in the post-economic reforms period of 1991-2003, by analyzing some pre- and post-merger financial ratios, in a sample of companies involving all mergers by public limited and registered with respective stock exchange in India. In specific, the study was aimed to understand which types of mergers have been more successful in improving the performance of merging companies, among vertical mergers, horizontal mergers, and conglomerate mergers.

Analysis of pre- and post-merger operating performance ratios for the entire sample set of mergers showed that there was no change in the average operating profit margin and gross profit margin ratios, there was significant decline in the net profit margin, return on net worth and return on capital employed, in the post-merger period. For mergers between similar group companies, there was a significant decrease in net profit margin due to likely increase in interest costs, while other profitability ratios, stayed unchanged. The significant decrease in profits on net worth and capital employed suggested that the mergers were not encouraged by efficiency enrichment likelihoods, but were directed at combining the asset base by merging assets of
several group companies to appear larger. Comparison of post- versus pre-merger operating ratios, for the dissimilar kind of mergers suggested that horizontal mergers had affected the maximum decline in the operating performance of the merging firms, followed by conglomerate and vertical mergers. The decreases were noticeable in terms of returns on net worth and capital employed, and to a smaller extent on net profit margin, among all kinds of mergers. The dissimilarities between unlike combinations of mergers yet, were not statistically significant, leading to the conclusion that merger outcomes were similar for all merger kinds. Michael (2008) examined role of strategy in corporate segment in wake of the financial crises of the late 1990s. The research accepted that worldwide financial establishments and specialists have to comprehend the need for a strategy to prevent and relieve the harshness of crises in the corporate world. Yasmeen (2008) also discussed that M & A strategy is a powerful tool for existence and development of the corporate world in India. He also discussed several strategies with the help of case analysis like acquisition of Gillette India Limited by Procter and Gamble

A. Managerial Control

Matsusaka (1993) investigated stock market response to acquisition announcements during and immediately after the conglomerate merger wave of the late 1960s. The most important finding of the study was that acquirer shareholder benefited from diversification acquisitions, which implies that diversification was not driven by managerial objectives. It was also found that buyers earned significantly positive announcement period returns during the conglomerate merger wave when they made diversifying acquisitions. The hypothesis that conglomerates wave driven
by empire building or some other managerial objective can be rejected because such explanations imply value decreases to unrelated acquisitions. It concluded that market responded positively to bidders who retained the management of target companies and negatively to bidders who replaced target management (Bradley, Desai, and Kim, 1988). Researcher made three contributions to the study of diversification: It directly tested and refuted one popular explanation for the conglomerate merger wave, it provided some indirect evidence on three other explanations, and it was presented as an empirical puzzle concerning the market’s changing sentiments over time.

Kavin (1999) studied the relationship between bank ownership concentration and corporate strategy. The research aimed at testing two hypotheses i.e. banking corporations that are controlled by their managers will be more active acquirers of other banks, and banking corporations that are effectively controlled by their managers will be more likely to engage in out-of-market bank acquisitions. The out of market bank acquisitions could be motivated by managerial opportunism, and lacking any cost advantages, these acquisitions may detract from the company value. The second hypothesis was amenable to testing with an ordinary least squares regression. The 156 sample banking firms, larger banks appear to be more active acquirers of other banks, irrespective of their previous profitability or their ownership concentration.

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First, it may be that something in the world changed between the 1960s and the 1980s. Some have pointed to antitrust regimes- there was tight enforcement in the 1960s and tax enforcement in the 1980s under the Reagan administration. A second explanation for the change in market sentiment had to do with first mover advantages and learning. Early conglomerates earned significantly positive returns simply because they were first; they may have captured some rents to organizational innovation that were subsequently driven to zero. A third explanation was that the market simply made a mistake about diversification (Matsusaka, 1993)
The corporate strategies of banks differ based on the presence or absence of an outside owner with a substantial equity stake. The empirical association of out-of-market acquisitions with manager-controlled bank was consistent with the agency-theoretic and managerial-capitalism context of research. The out of market acquisitions may not yield cost reductions because they lack the overlapping operations associated with M & A when both acquirer and target have a presence in the market. The evidence also suggested that out of market acquisitions increased bank size but did not improve acquiring bank performance. Although manager controlled banks were not be able to make a larger number of acquisitions than their owner controlled counterparts, they may be willing to undertake less efficient acquisitions in order to grow while maintaining the stability of their employment.

Vedpuriswar (2003) investigated risk in M & A. An unbiased analysis of the possible benefits and drawbacks involved is imperative before going ahead with M & A. Board directors have a key role to play here, particularly the external directors. CEOs must be meticulously examined and requested to explain the benefits of M & A. Once the decision to go ahead with the merger is announced, the focus shifts to incorporation of new company. This was a job which is underrated by most companies. It is concluded that the efficiency of management of the combination process determine whether the projected synergies materialize. The complexities in planning and executing M & A make them very risky and CEOs in rush to complete M & A deals should never undervalue the risks of M & A.
Nandita (2004) conducted a study to explore the evolution of Corporate Governance policies pursued in India for the private corporate sector in relation to the market for corporate control with a view to identify the changing trend in such policies in the post-liberalization regime. Matthew and David (2008) also studied the property rights theory of the company to empirical regularities in the market for M & A and illustrated concept of who buys whom.

B. Cross-border M & A

Jun-Koo (1993) presented evidence that Japanese M & A in the U.S. generated statistically significant wealth gain for both Japanese bidders and U.S. targets. Consistent with the opinions advanced by Jensen (1986), Fama (1990), and Froot and Stein (1991) and with other literature on FDI and the market for corporate control, he also found that bidder-specific qualities and dollar-yen exchange-rate movements were beneficial in the cross-sectional variation in bidder returns; returns to Japanese bidders and to the portfolio of Japanese bidders and U.S. targets increased with the bidder’s leverage, the bidder’s ties to financial institutions through borrowings, and the depreciation of the dollar in relation to the Japanese yen. Sub-period results showed that the key findings for the overall sample period are determined by the last three years of deals i.e. 1986-88.

Rotting (2007) addressed normal hitches in international M & A, and has produced a typology of strategies that may restrict these hitches. They concluded “that despite the extensive body of research on M & A that has accumulated over the last thirty years, the key factors for M & A success
and the reasons why so many M & A fail remain poorly understood” (Stahl and Mendenhall, 2005: xiii). Even though a substantial body of research has expounded bearing in mind cultural distance as the key reason for the collapse of international M & A, practical conclusions are mixed and inconclusive. The key hypothesis made was that cultural distinctions may not necessarily act for an unfavorable force influencing international M & A. As an alternative, incompetent management of the cultural amalgamation process in the post-acquisition phase may be accountable for the large number of poorly performing cross-border M & A. The framework developed by researcher recommended that victorious cultural combination is influenced by cultural due diligence, cross-cultural communication, control, and connection which was referred as the “Five C’s Framework” of rewarding international M & A management.

Jing (2012) presented the strategic trends in recent years for M & A of transnational corporations in China. M & A strategy of MNCs in China successfully executed, not only objective requirement of political reform and economic growth in China, there are also unintentional by Chinese business men and government of the subjective mistakes caused. It concluded that to prevent risk of multinational M & A in China, Chinese companies need to increase awareness of multinational M & A, cautiously select joint venture partners, and develop comprehensive learning system in joint venture or cooperative, improved studying competencies, and enriched management of M & A strategies.
C. Strategy process of M & A: case study of Novartis

Schmidt and Rühli (2002) carried out case study of the Novartis, world’s largest merger between Ciba and Sandoz in Switzerland, market valued of $80 billion. The case study explained that the mega merger initiated not a fundamentally new or innovative strategy processes. It is not possible for a merged entity to achieve a complete change in strategic orientation while continuing its operational business. The case study also showed that the merger theory is very much aligned to prior strategy processes of the merging companies. It is essential for the management of companies intending a merger to comprehend challenges between their own and their merger partners’ strategy processes developed earlier to the merger. The selected strategy of a merged corporation is by and large the consequence of a not immediately transparent process of negotiation and communication between the management bodies of the merging companies.

- Market for Corporate Control:

M & A are big part of the corporate finance; corporate assets would be channeled towards their best possible use. M & A transactions that bring together separate companies to make larger ones. When they are not creating big companies from smaller ones, corporate finance compulsions do the reverse and break-up companies through spin-offs, or tracking stocks. Strong companies act to buy other companies to create a more competitive and cost-efficient company.
The literature on foreign direct investment (FDI) and the market for corporate control recommended that overseas M & A are inspired by numerous factors, such as limitations in product and factor markets (Hymer, 1976, Caves 1971, and Kindleberger, 1969), drawbacks and irregularities in capital markets (Froot and Stein, 1991), dissimilarities in tax rules and regulations (Scholes and Wolfson, 1989), and executive management that take action in its individual interest to the impairment of shareholders wealth (Jensen, 1986).

Modifications in U.S. tax laws in the 1980s influenced Japanese M & A movement in the United State of America (USA). Scholes and Wolfson (1989) opined that the Economic Recovery Tax Act (ERTA) of 1981 dissuaded M & A deals between the U.S.A sellers and overseas buyers; it raised the demand for deals among the U.S.A companies. It accelerated devaluation programmes and more substantial investment tax credits presented in the ERTA of 1981raised tax motivations for the U.S.A buyers, but put overseas buyers at a shortcoming. Scholes and Wolfson (1989) also opined that this drawback was removed by the Tax Reform Act (TRA) of 1986, which decreased the marginal corporate tax rate in the U.S.A, making the U.S.A a tax haven for several Japanese and European companies that encounter higher corporate tax rates in their domestic countries. However, the experiential effort on the market for corporate control showed that target companies achieved substantial gains from local acquisitions (Jensen and Ruback, 1983; and Jarrell, Brickley, and Netter, 1988). It is not recognized whether the wealth gains fluctuate for target companies of Japanese and the U.S.A companies. Since the concept of FDI assumed that limitations in product markets, capital
markets and factor markets provide MNC companies a competitive benefit above local companies in the domestic county (Kindleberger, 1969; Caves, 1971; Hymer, 1976; and Froot and Stein, 1991), cross-border M & A are expected to generate more wealth than local M & A. Since target companies are likely to gain maximum benefits of M & A, the FDI concept suggested that wealth gains to targets of Japanese companies are superior than those to targets of the U.S.A companies. Harris and Ravenscraft (1991) also concluded that the U.S.A targets of overseas buyers have substantially greater wealth gains than do those of the U.S.A companies.

Steven and Michael (1992) used market model parameters to determine the market reaction for acquirers and targets to the acquisition announcements, over the period from 300 to 61 trading days before the first announcement in the Wall Street Journal that a company was seeking control of the target. Abnormal returns, calculated for the period beginning five trading days before the acquirer’s first announcement for acquirers. It was seeking control of the target and ending five trading days after the announcement of the ultimately successful bid or outcome. Researchers conducted a significance tests using standard errors and cross-sectional announcement period returns. These standard errors tend to be large then those calculated using returns from the market model for estimation period (As proposed by Patell, 1976). Acquirer returns and total (acquirer and target) returns at the acquisition announcement were significantly lower for unsuccessful divestitures than for successful divestitures and acquisitions not divested. Although diversifying acquisitions were almost four times more likely to be divested than related acquisitions. There was no strong evidence found that diversifying acquisitions were less successful than related ones.
Ronald and Hemmo (2001) opined that benefits of M & A were questioned in several reports that examine the price reaction of the stocks involved. In long run it was reported an under performance in the year after the merger or acquisition. In short run, the results were mixed. It was focused on the short-run stock price performance of firms involved in a merger or acquisition. It also looked at the reaction of equity analysts by examining the changes in consensus earnings estimates for the post-announcement years. It has used a global sample for the relatively short time period of one year. The ongoing downward earning revisions by analysts suggested a lack of synergies and thereby indicated that the out performance was unjustified. These findings were in conflict with the efficient markets hypothesis. In the case of analyst’s earnings revisions, acquirers appear to reap the fruits of their takeover after two years at the earliest. There was a lack of upward revisions, but relative to the market earnings estimates noticed better performance. The study also highlighted those investors who want to play M & A game is focused on potential targets, because they show attractive out performance on an announcement. Finally, it was concluded that M & A be worth of critical assessment.

Vojislav and Phillips (2001) carried out a study to analyse the market for corporate assets in manufacturing industries. In the USA each year during the period 1974 to 1992, an average 3.89% of the large manufacturing plants in the country changed ownership. The main three results on the probability assets sold were as follow: For multiple – division companies, the probability of a company selling assets decreases with both the asset’s and the segment’s productivity. The probability of mergers and company sell-offs was higher
when selling company was less productive and the industry experiences a positive demand shock; the selling company’s productivity in other divisions impacts the probability of a sale. A division was more likely to be sold the better the prospects of the other divisions and it was found that the probability that company was a buyer of additional assets increases with efficiency and size.

The results were consistent with more skilled buying companies being able to transfer skill and improve the assets purchase. There was no evidence that manager of conglomerate companies were less enthusiastic to sell assets than manager of single segment companies. The results indicated that efficient companies refocusing in booms might produce the highest profits to transaction. It concluded that the market for corporate assets facilitates the redeployment of assets from firms with a lower ability to exploit them with higher ability.

Mihkel M. Tombak (2002) carried out a study to examine the horizontal merges between companies that have different cost. The Horizontal mergers between asymmetric companies have been concluded as a three-stage game⁸. There were two reasons for buying the most efficient rival companies; first, it reduces the profits of the acquiring company and second, it reduces the subsequent purchase prices by reducing the reservation values of future targets to those of their present profits. It used game-theoretic model to examine the incentive to merge companies engaged in either Cournot or Bertrand

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⁸In the first stage owners decide on which company to acquire or sell. The purchase price was determined between pair of possible buyers and sellers after bargaining game. The owner of several companies then decides on whether to consolidate company in second stage. In the final stage, with efficiencies and market structure determined in the first two stages, companies competed in an asymmetric Cournot game. These three stages were repeated until no further gains to acquisitions can be made.
competition in various types of product markets with diverse production technologies. It was found that, given a choice, acquiring companies were more likely to attempt to purchase their most efficient and largest rivals first and that this may lead to monopolization.

Shareholders of target companies customarily obtain large premiums (on an average 10% to 30%) relative to the pre-announcement share price. Jarrell and Poulsen (1989), Servaes (1991), Kaplan and Weisbach (1992) and Mulherin and Boone (2000) for example, reported for average abnormal returns of 21% the U.S.A. target companies (for year 1990-99), 27% (year 1971–82), 24% (year 1972–87) and 29% (year 1963–86), respectively. Likewise to their U.S. counterparts, the UK and Continental European target companies gained average returns of 24% during the period 1955-85 (Franks and Harris 1989), 19% in 1966-91 (Danbolt 2004), and 13% in 1990-2001 (Goergen and Renneboog, 2004).

- **Synergy:**

  The synergy gain denotes the increases in value (i.e. \( \Delta V \geq \Delta V_B + \Delta V_T \)) of the combined entity than the stand alone values of acquiring company as well as the target company. Sirower (1997) defined “synergy as increases in competitiveness and resulting cash flows beyond what the two companies are expected to accomplish independently” (p.6). Synergy gains can occur from several sources, like functional synergies are created from economies of scale, from increased market power, from a more competent deployment of available resources and from decreased agency costs. One more important source of synergy may be from the potential to transfer valuable
intangible assets, such as know-how, between the combining companies in the presence of transaction costs that lead to failure of factor markets (Caves, 1982). The potential for acquires to realize gains from taking over companies with high levels of agency problems and taking action to resolve these problems was a motive for acquisitions in general.

Sirower (1997) conducted study to examine whether M & A is good for shareholders or presumably for the economy. The acquisition premium represents the hope of synergy in a corporate combination. Where high premiums were paid, the values of synergies often have to be substantial to reach a break-even point and this was what Sirower described as the ‘synergy trap’.

The valuation of uncertain future benefits such as synergies is difficult and this part of the overall valuation is therefore, often not performed at all, or inadequately addressed. It assessed the significance of synergy identification and evaluation in the pre-deal stage of M & A. Synergies is only realized through post-merger integration of both processes and people, where a premium has been paid for the acquisition. The slower the integration the slower the recognition of synergies and was more expensive. Adding synergy means creating value that not only didn’t yet exist but was not yet expected.

Kode, Ford, and Sutherland (2003), provided a conceptual model for evaluation of synergies in M & A. The majority of M & A rely on synergies in the value creation process. Just small proportions of M & A were undertaken for non-synergistic reasons. Synergies were used to give explanation for the payment of premiums, executive management need to fully understand how to
evaluate synergies. The analysis was in the form of a documentary review via content analysis (Babbie, 1998). It consisted of a detailed scanning of the literature on the subject to identify common threads and to crystallize the thinking around it. As per literature the payment of too high an acquisition price and the lack of planning to integrate the organizations are the leading causes of failure. Three additional issues were identified for the generations of productive synergies: 1) Aulinger and Copeland (1996) identified that the existence of modern operating strategies in M & A was the single largest source of value creation in successful acquisitions, whereas most author focused on the usual drivers of synergistic gains i.e. financial research has shown that many combinations fail because of failure to evaluate synergies adequately or at all. 2) Haspeslagh and Jemison (1991) recognized the key difference between success and failure in M & A as being the survival of a superior understanding of the decision-making process. 3) Marks and Mirvis (1997) have separated an unhealthy focus by decision-making on the financial implications of M & A.

A. Managerial Control

The hubris hypothesis (Roll, 1986) suggested that acquisitions occur because managers make mistake in evaluating target companies and the takeover premium merely reflects a random error. As Roll (1986; p.200) described as, “Financial markets are assumed to be efficient in the asset prices reflect all information about individual firms. Product and labor markets are assumed efficient in the sense that (a) no industrial reorganization can bring gains in an aggregate output at the same cost or
reductions in aggregate costs with the same output and (b) management talent is employed in its best alternative use”. The strong form market efficiency assumption of the hubris hypothesis contrasts with the assumption underlying the synergy hypothesis that these exist frictions in product or factor markets. In addition, whereas the synergy hypothesis assumes rational profit maximizing behavior on the part of individual managers, the hubris hypothesis in its extreme form assumes irrational individual behaviour, since rational manager would realize that any bid above the market price is an error and desists from market such as bid.

Seth, Song and Pettit (2000) conducted study to examine the motive underlying foreign acquisitions of the USA companies, estimated the extent of value creation associated with such M & A and examined how total profits were shared between acquiring and targets companies. Event study methodology was applied to estimate abnormal returns of acquirer and target companies. The managerialism hypothesis suggested that managers embark on acquisitions to maximize their own utility at the expense of the shareholders of the company. Since managerial compensation frequently was tied to the amount of assets under their control, managers were more likely to seek higher rate of growth in assets than profits (Marris, 1964). The hubris hypothesis suggested that bidding firm managers make mistakes in evaluating targets companies but undertake acquisitions presuming that their valuations were correct. Multiple empirical approaches were used to test the synergy, managerialism, and hubris hypotheses in the cross-border acquisitions.
Mitchell and Lehn (1990) showed that bidders in “bad” acquisitions are more likely to be taken over themselves. It was examined the mean level of the gains to acquirers and targets and the total gains to the pair of combining companies, and also the proportion of acquisitions in our sample with positive total gains. It was also examined the correlation between the gains to the target and total gains to the combined firm and gains to the acquirer and the target, similar to the approach of Berkovitch and Narayanan, 1993. Empirical tests indicated that the synergy hypothesis explained gains in the majority of cross-border acquisitions. At the same time, the hubris hypothesis appeared to play a role in value creating transactions. Cross-border acquisitions characterized by value destruction appear to be driven by managerialism rather than by hubris.

B. Shareholder Protection:

Rossi and Volpin (2004) studied the volume of M & A activity and it’s linked to both the level of shareholder safety and the characteristics of accounting standards. They found that merger premium was related to the level of shareholder fortification. However, their outcomes emerged to be driven by the U.S.A and the U.K market interpretations. Starks and Wei (2004) also concluded that for stock acquisitions, the market response for the target company is lower when the acquirer is domiciled in a country with powerful marginal shareholder fortification, but that the market response for the acquiring company in these acquisitions is higher. They explained their conclusions as evidence that dissimilarities in the level of marginal shareholder fortification between targets and acquirers companies influenced the sharing of synergy gains.
However, the conclusions of Bris and Cabolis (2008) are also for the most part consistent with Starks and Wei (2004). Bris and Cabolis (2008) found that the stock market response to the merger announcement for target companies is higher when the acquirer is from a country with powerful fortification of marginal shareholder benefits or when the accounting standards in the country are more crystal clear and that the response is not symmetric across acquiring and target companies. Thus, whereas earlier research has shown that cross-country dissimilarities in marginal shareholder fortifications and accounting standards influence merger premium, prior research has not discovered reliable conclusions concerning whether the total synergy gains or the sharing of synergy gains is pretentious by these qualities.

- **Wealth Maximizations:**

  A number of studies were completed in developed capital markets, like Europe, Australia, Japan, and the USA, on evaluation of corporate financial wealth maximization following M & A. Weston and Mansingka (1971) studied the pre and post-merger stock price performance of conglomerate companies, and concluded that their earnings rates significantly underperformed those in the control sample group, but after 10 years, there were no significant dissimilarities noticed in functioning among the two groups. The correction in earnings performance of the conglomerate companies was illuminated as evidence for successful accomplishment of suspicious reformation.
Jensen and Ruback (1983) reviewed the scientific literature on the market for corporate control. The evidence indicated that corporate takeovers generate positive gains that target company shareholders gain and acquiring company’s shareholder do not lose. Lubatkin (1983) reviewed the conclusions of studies that have examined either directly or indirectly the question, “Do mergers provide real benefits to the acquiring firm?” The review recommended that acquiring company might gain from M & A because of technical, financial and diversification synergies. Katsuhiko and Noriyuki (1983) also examined the financial performances of 43 merging companies in Japanese manufacturing industry and concluded that the rate of return on equity share increased in more than half the situations, but rate of return on total assets was enhanced in about half the circumstances. However, both profit percentage rates showed enhancement in more than half the transactions in the five-year test, recommended that company performances after mergers started to be enhanced along with the internal adjustment of the merging companies: there was a necessary gestation period during which merging companies educated how to manage their new restructured organizations.

Healy, Palepu, and Ruback (1992) studied post-acquisition functioning for 50 largest the U.S.A mergers between 1979-1984 by calculating cash flow performance, and concluded that operating performance of merging company enhanced considerably subsequent to M & A, when compared to their particular industrial segment. Ghosh (2001) also studied the same question that whether operating cash flow performance enhanced subsequent to corporate M & A, utilizing a model that accounted for excellent pre-acquisition performance, and found that merging company did not show supporting data of enhancements in the operating performance subsequent to M & A.
Loughran, and Vijh (1997) carried out study to examine the relationship between the post-acquisition income and the mode of acquisition and form of payment. This research was different in two respects, i.e. the previous review recognized that post acquisition abnormal returns were inconsistent with market efficiency and the computation of excess returns. The sample was classified based on the mode of acquisition i.e. merger or tender offer and the form of payment i.e. stock or cash. Both variables have been examined in the context of wealth gains from acquisitions. It was observed that tests of long-term returns were joint tests of market efficiency and wealth gains from mergers and tender offers. It was found that our results on stock acquisitions were different from stock issues. It was also examined that the cumulative abnormal returns from holding the target stock from two days before the first announcement date to effective date and then rolling over the proceeds for another five years by investing in the acquirer stock. It was possible that some of the excess returns earned by cash tender offers may be the result of investors under estimating the possible gains from disciplinary actions associated with tender offers, such as the appointment of new managers. The results suggested that in the case of stock merger, the gain tend to dissipate within five years even if the acquisition succeeds. The overall wealth gains of target shareholder from stock mergers by combining the pre-acquisition returns and post-acquisition returns. Target shareholders gained from all types of acquisitions seems to be a generally accepted result in the finance literature.

performance in the five-year period following mergers, the study found
evidence of improvements in operating performance, and also that the pre- and
post-merger performance was highly correlated. The study concluded that
control firm adjusted long-term operating performance following mergers in
case of Japanese firms was positive but insignificant and there was a high
correlation between pre- and post-merger performance. Marina, Martynova,
Sjoerd and Renneboog (2007) investigated the long-term profitability of
corporate takeovers in Europe, and found that both acquiring and target
companies significantly outperformed the median peers in their industry prior
to the takeovers, but the profitability of the combined firm decreased
significantly following the takeover. However, the decrease became
insignificant after controlling for the performance of the control sample of
peer companies.

A. Short-run event studies

The short-run event study is summarized in Table – 3:1. Only the
erlier studies in the US by Asquith et al. (1983) and in the UK by Franks
and Harris (1989) found significant positive returns to acquirers. It also
showed that both of these studies included takeovers in the 1950s (Franks
and Harris, (1989)) and the 1960s (Asquith et al, 1983) when takeovers
emerge to have been more favorable to acquiring companies shareholders.
The remaining studies from both the UK and the US concluded either no
significant variance in the returns of acquirers or found significantly
negative returns around the offer announcement. Additionally, after 1980
research noticed increasingly negative performance of acquirers, a finding
consistent with evidence explained by Andrade et al. (2001). It is also
worth noting that evidence from other countries tends to be more positive than conclusion documented for the UK and the US. For example, Campa and Hernando (2004) described insignificant gains from a sample of Continental European takeovers, while Ben-Amar and Andre (2006) highlighted positive announcement returns from a sample of listed Canadian acquirers. Sudarsanam and Mahate's (2003) carried out study of the short-run performance of a sample of 519 UK acquirers between 1983 and 1995. The researcher showed significantly negative abnormal returns of 1.4% (over the -1 to +1 day window) with only 3rd of acquirers come across wealth gains. For the extended post announcement period (-2 to +40 days), Sudarsanam and Mahate (2003) also explained generally negative abnormal returns but didn't found the differences to be statistically significant and findings are broadly similar to Limmack (1991) and Gregory (1997). However, almost 70% of acquirers revealed wealth losses over the extended event window.

B. Long-run event studies:

A great deal of research studies conducted to evaluate the long-run post-acquisition performance of acquirers. Much of this has been motivated between 1960-1980, studies recommended that takeovers may have a negative return on the long-run wealth of shareholders (Asquith 1983; Malatesta 1983). However, many of the studies (i.e. in the 1970s and 1980s) examined the post-acquisition performance of acquirers as part of a more widespread analysis of takeovers; while the past period has seen more studies concentrating completely on acquirer performance.
The long term event studies are highlighted in Table - 3:2, Long team studies recommended that takeovers produce either insignificant or negative abnormal returns in the long run. In the UK, for example, Limmack (1991) noticed significantly negative returns for a sample of 448 takeovers between 1977 and 1986. Kennedy and Limmack (1996) found significantly negative returns to bidders involved in takeovers during the 1980s. Gregory (1997), in a research of takeovers between 1984 and 1992, concluded significant negative post-takeover returns. Eventually, Sudarsanam and Mahate (2003, 2006) also found significant negative returns in the post-offer period. A study by Alexandridiset al., (2006) used the three-factor model devised by Fama and French (1993) and the customary Capital Asset Pricing Model (CAPM) method. Both models provided a negative abnormal return of around 1%, which is robust when returns are calculated from equally-weighted and from value weighted portfolios. Gregory and McCroriston (2005) found that acquirers lose 9.36% and 27% following from the date of announcement after 3 and 5 years respectively whereas there were no significant returns for 0 to -2 years. Conn et al., (2005) computed abnormal returns for a sample of the UK companies and concluded that acquirers lost around 20% over three years. Thus, the overwhelming concurrence is that shareholders in acquiring companies experience significant wealth losses when long-run returns are taken into account.

However, discussing conclusions of event-studies, it highlighted that this particular research method is associated with a number of methodological problems. Despite the fact that short-run studies are
somewhat straightforward and trouble free (Kothari and Warner 2004), it should be cherished that they are at risk from preconceived notion, since announcement returns tend to reveal the expectations of shareholders. Long-run event studies are connected with more significant difficulties. First, the elucidation of research findings is not so straightforward, as all tests are basically joint tests of whether abnormal returns are zero and whether the assumed model of expected returns (i.e. CAPM, market model, etc.) is acceptable. Secondly, ordinary t-tests necessitate data that are normally distributed. Since long-run share price returns be inclined to be skewed, substitute tests have been formed in an endeavor to take this skewness into account. Thirdly, the dependability of long-run event studies may also be destabilized by thin trading and the overlapping of event periods. Overlapping events cause predominantly acute difficulty in evaluating the long-run performance of acquiring companies as, over a period of years, a range of company-specific events (counting subsequent acquisitions) may persuade the share price returns. One way of dealing with these difficulties is to run the analysis without companies experiencing thin trading and by not including bidders other offers within a certain period of the event under examination (Gao and Sudarsanam, 2004). Fourthly, much of this study uses the CAPM as a yardstick measure for abnormal returns. There is substantial evidence that the time series properties enhance when a longer period is used (5 years data is the rule of thumb (Groenewold and Fraser, 2000)).

9Thin trading refers to extended periods where a particular stock is not traded.
• **De-merger:**

As opposed to M & A, the strategy of demerger was a theme that has been equally dominant among corporates. Leading corporate groups have opted for demergers to attract attention and create greater shareholder wealth. Indian companies like, Godrej Soaps, Dabur India, and Indian Rayon have used demerger as a tool to maximize focus and shareholder wealth.

As long as there was a sharing of common interest between different businesses of group, diversification emerged as a better strategy for growth. However, with the difference between various businesses now standing out more clearly than ever before, demerger has evolved as a better strategic tool in the corporate survival game. It was believed that in today’s fiercely competitive global market landscape where factors like, business cycles, economics and investment requirements determine the fate of a business entity, demerger makes sense.

Demergers, however, have their own pros and cons. Concerns related to issues such as operational costs, distribution of financial assets, transfer of debt obligations and loss of identity weigh equally in demerger cases. Hence challenge lies in managing the transition i.e., in managing the change from being a part of a conglomerate to focused entity, managing internal and external challenges, linking functional excellence to business results, changing the mindset, and establishing systems and structures to help realize what is enshrined in corporate vision and mission statement.

Singh and Goodrich (2006) examined the split that followed the failed succession plan for Reliance Industries Limited is one of the most significant and exposed story in Indian business segment. In the absence of a concrete
succession strategy in the case of Reliance Industries after the death of D. H. Ambani, given the fact that it was one of the biggest private sector company and most successful exchange swapped conglomerates, the economic effects in terms of corporate value erosion and shareholder wealth destruction were massive. The ambiguous environment after the demise of Dhirubhai in 2002 has had negative effect on company’s equity stock performance. In addition, unveiled proposal of de-merger and splitting of RIL kingdom between the two brothers. There was value destruction due to lost diversification benefits, synergies, economies of scale and scope, and complementarities. This case study explained the effects of the dispute of two brothers on corporate value and continuation of well-organized business practices.

A. Case Studies

Demerger of Reliance has led to an effective delisting of a significant part of the company. On January 18, 2005 a special trading session was held to determine the price of the demerged Reliance Industries. It was established that the demerged company was worth a little over three quarters of the undivided company. By implication, the four companies that were demerged out of Reliance Industries collectively accounted for about a quarter of the value of the undivided company. Reliance Industries (or rather the three quarters that continue under that corporate umbrella) continues to be a listed company, but the four companies that were demerged out of it are also listed companies. On January 18, 2005 therefore, about a quarter RIL was effectively de-listed\textsuperscript{10} from respective stock exchange of India.

\textsuperscript{10}It means, millions of shareholders in these companies cannot trade these shares, the corporate governance provisions of Clause 49 on independent directors and investor protection do not apply to
Reliance Industries Ltd (RIL), on August 5, 2005, announced its plans of de-merging the telecommunications, coal based energy, financial services and gas based businesses into four different companies, viz Reliance Communications Ventures Ltd (RCVL), Reliance Energy Ventures Ltd (REVL), Reliance Capital Ventures Ltd (RCLVL) and Global Fuel Management Services Ltd (GFMSL).

Table – 3:3. What RIL shareholders will get?

<table>
<thead>
<tr>
<th>New Co.</th>
<th>Per share of RIL Holding</th>
</tr>
</thead>
<tbody>
<tr>
<td>RCVL</td>
<td>1 share of ₹5 each</td>
</tr>
<tr>
<td>REVL</td>
<td>1 share of ₹10 each</td>
</tr>
<tr>
<td>RCLVL</td>
<td>1 share of ₹10 each</td>
</tr>
<tr>
<td>GFMSL</td>
<td>1 share of ₹5 each</td>
</tr>
</tbody>
</table>

Table - 3:4. Demerger of RIL holdings

<table>
<thead>
<tr>
<th>New Co</th>
<th>Taking over business of</th>
<th>RIL Holding</th>
</tr>
</thead>
<tbody>
<tr>
<td>RCVL</td>
<td>Reliance Communications Infrastructure Ltd</td>
<td>900mn shares each of ₹1 FV</td>
</tr>
<tr>
<td></td>
<td>Reliance Infocomm Ltd</td>
<td>3193mn shares each of ₹1 FV</td>
</tr>
<tr>
<td></td>
<td>Reliance Telecom Ltd</td>
<td>7.1mn shares each of ₹10 FV</td>
</tr>
<tr>
<td>REVL</td>
<td>Reliance Energy Ltd</td>
<td>90.9mn shares each of ₹10 FV</td>
</tr>
<tr>
<td>RCLVL</td>
<td>Reliance Capital Ltd</td>
<td>60.1mn shares each of ₹10 FV</td>
</tr>
<tr>
<td></td>
<td>Reliance General Insurance Co. Ltd.</td>
<td>25.5mn shares each of ₹10 FV</td>
</tr>
<tr>
<td></td>
<td>Reliance Life Insurance Co. Ltd.</td>
<td>0.5mn shares each of ₹10 FV</td>
</tr>
</tbody>
</table>

these companies, and these companies are under no obligation to provide the continuing material event disclosures to the exchange that a listed company is required to.

Since Reliance Capital Ltd and Reliance Energy Ltd are already listed on the bourses, RCLVL and REVL merged with them respectively. For every 100 shares held in RCLVI, shareholders received 5 shares of Reliance Capital Ltd and for every 100 shares held in Reliance Energy Ventures Ltd shareholders received 7 shares in Reliance Energy Ltd. The Specified Shareholders i.e. Trustees of Petroleum Trust (holding 7.5% of RIL) and four companies - Reliance Aromatics and Petrochemicals Pvt. Ltd., Reliance Energy and Project Development Pvt. Ltd., Reliance Chemicals Pvt. Ltd. and Reliance Polyolefins Pvt. Ltd (collectively holding 4.7% of RIL) held RIL shares for the economic benefit of RIL shareholders. As a result thereof, the total number of shares to be issued by each of the resulting companies would be 1,220mn as against 1,390mn equity shares of RIL.

Godrej Consumer Products Ltd., (GCPL) was the new entity for the consumer products division of Godrej Soaps Limited (GSL) after demerger into two new companies. Post demerger, GCPL owns all its brands, which include some top of the mind brands like Cinthol, Fair Glow, Ezee and Godrej Hair dye, etc. GCPL is a high growth, highly profitable FMGC operation. A balance sheet loaded with heavy and a complex product profile did not help the erstwhile Godrej Soaps get the kind of valuation its peers in the FMGC sector commanded. In financial year 2000, the contribution of the chemicals divisions to the overall revenue of the company was to the tune of a substantial 42% while the consumer products business added another 55% to it. This significantly high contribution from chemical division prevented the company from being treated as a FMGC company.

A crippling debt burden of about ₹ 464.4 crores in 1999 had caused the market sentiment to turn negative. The problem on valuation front got
aggravated by the maze of cross-holdings the company had in many of its group companies, which included Godrej Foods, Godrej Sara Lee, Godrej Pillsbury, and Godrej Agrovet. The concern for an abysmally low valuation and blurred vision toiletries and personal care division into separate entity to be named as Godrej Consumer Product Ltd. Demerger was looked on as a strategic step to achieve greater focus on individual businesses in order to gain competitive edge. The demerger came into effect from April 2001.

After demerger the first quarter of the financial year 01-02 of GCPL as an independent entity was quite encouraging. GCPL recorded a growth of 10% in the soap category at a time when the industry as a whole witnessed a decline of 10%. In the hair color segment too, GCPL registered a growth of 34% as against 20% industry wide growth. It increased market share in both soaps and hair color segment by 11% and 6% respectively. The company reduced its debts by ₹34.4 crores which led to an improvement in its debt-equity ratio to 0.60% from 1.43%. The company’s ROCE (Return on Capital Employed) stood at 65.8% and RONW (Return on Net Worth) at 63.4% for the period under study.\(^{12}\)

The Wockhardt, which had traditionally been a conglomerate, operating in as diverse business as pharmaceuticals, agri-science, parentals and hospitals, had been losing focus and was not commanding the kind of valuations its peers like Ranbaxy and Dr. Reddy were accorded; Dr. Reddy’s lab and Ranbaxy enjoyed P/E multiple of more than 80%, while Wockhardt could manage just 50%. The company’s woes stemmed from the fact that the core requirements of each of these businesses – capital, technology and distribution strength were diverse and hence required total focus.

\(^{12}\)(Case; Godrej Soaps, Mergers and demergers, concept and cases, by Amit Singh Sisodiya, The ICFAI University Press, 2004)
To have focused businesses and improve shareholder wealth, the company engaged the services of Mc. Kinsey, a global management consultancy company. Mc. Kinsey recommendations included splitting the company into two separate business entities to improve valuation. The vertical split was suggested so as to remove the drug of the large asset base of the non-pharma business, around 80% of the earning (before interest and depreciation) of the company were from the pharma division, which had less than 35% of the total assets. The company believed that ROCE from the current levels of around 11% would move up to more than 30% for pharma division while for life science division the same would go down to 6%. The reason for such large variation in the company’s ROCE was the massive amount of real estate assets in the books of the life sciences division. These assets were proving to be a drag on the group’s overall profitability.

The rationale behind the demerger was to unlock the full potential of Wockhardt businesses by creating two separate companies. Wockhardt Ltd was planned to be totally focused on the knowledge based pharmaceutical business at the same time concentrating on being globally competitive and creating large brands, Wockhardt Life Science Ltd was decided to include IV fluids, agri-sciences and hospital business and leverage on the opportunity to realize its full growth potential in the next decade. The demerger came into effect from January 1, 2000. As a process of demerger, the existing company Wockhardt Ltd was renamed Wockhardt Life Science while the demerged entity, which comprises pharmaceutical business, was named Wockhardt Life Science Division. The agri-sciences business, parentals and hospital business were transferred to Wockhardt Life Sciences Division.
Wockhardt registered a healthy growth rate in both top line as well as bottom line during the first half of financial year 2002. The company’s sale grew by 15.6% while its profit after tax increased by 39%. The company’s operating profit during the period grew by an impressive 36%, this helped operating profit margin to improve by 280 basis points (bps) to 18.4% to 15.6%. The company’s ROCE also improved remarkably by 450 bps from 21.3% recorded in the last financial year ending Dec. 31, 2000 to 25.8% in the first half of financial year 2002.

- **Reverse Merger:**

A Reverse Merger is a transaction whereby the private company shareholders may gain control of a public company by merging it in with their private company. The private company shareholders receive a substantial majority of the shares of the public company (normally 85% to 90% or more) and the control of the board of directors. The transaction is accomplished in as little as two weeks, resulting in the private company becoming a public company. The transaction does not go through a review process with state and federal regulators because the public company has already completed the process. The transaction involves the private and shell
d company exchanging information on each other, negotiating the merger terms, and signing a share exchange agreement. At the closing the public shell company issues a substantial majority of its shares and the board control to the shareholders of the private company. The private company shareholders pay for the shell and contribute their private company shares to the shell company and the private company is now public.

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13Case: Wockhardt, Mergers and demergers; concept and cases, by Amit Singh Sisodiya, The ICFAI University Press, 2004

14The publicly traded corporation is called a “shell”
Arellano and Brusco (2002) carried out study on Reverse Mergers (RM). Researcher explored the RM technique as a going public method that was an alternative method to the traditional Initial Public Offering (IPO). William (2006) also examined the reverse merger method of going public. Researcher constructed a simple three-period model in which at time zero nature determines the “type” of the company. The type represents the probability of getting a positive net present value project at time- two. The model predicted that under suitable conditions a separating equilibrium exists. A company with a large enough probability to undertake the project prefers to issue equity via an IPO, signaling the quality of the project. The model also predicted that only high quality companies were going to issue equity via an IPO and that RM was a method followed in general by lower quality companies. Researcher concluded that an extremely low proportion of companies that went public through a RM have later issued equity, a total of 8 companies representing 15.3% of sample. They also found evidence supporting the idea that the cost of a RM that includes a seasoned equity offering was approximately equal to the cost of an IPO therefore, the argument that the RM was a cheaper way to go public than the IPO was not supported by the data.

Gleason et al. (2005) examined 121 RM companies that taken place predominantly during the technology advancement. They concluded that RM companies experience from lower profitability and have a shorter existence. Only 46% of their sample companies carried on for two years following to the
merger. Yet, the shareholders of these companies received significance wealth gains, an average of about 25%, during the 3-day merger announcement window. Adjei et al. (2007) concluded that RM companies are smaller and newly developed, and have, on average, an inferior functioning compared to IPO companies. Further, they found that 42% of companies are delisted within three years of their establishment due to RM. Based on a larger sample size of 408 RM, Floros and Shastri (2009) also discovered evidence consistent with earlier studies that RM companies are smaller in size and have poorer profitability, in fact in some cases, even lower than penny stock IPOs. Up-till now, no study has explored the characteristics of financial reporting by RM companies, in general, and by the RM acquiring company’s country of domicile in particular.

3.3. Conclusion:

From the above review of the literature related to M & A, it was observed that M & A has been a business strategy in the recent past and several companies of various natures have opted for it to enhance their efficiency. Studies revealed that the M & A increase the size of the companies and don’t necessary improve the performance. There was no strong evidence that diversifying acquisitions were less successful than related ones. It was also observed that horizontal and vertical mergers showed positive and significant abnormal return. Synergy was the reason for major takeover over yet it was found that many takeovers were motivated by agency and hubris.
Studies also showed that bad managers were also bad acquirers consistent with the notion that poor performance drives managers to try something new. The hubris hypothesis concluded that acquisitions occur because managers make mistake in evaluating target companies and the takeover premium merely reflects a random errors. Despite cross country study, the question remains enigmatic as to why managers indulge in takeover game since wealth maximization hypothesis remain unresolved dilemma which provides fertile ground to study the M & A during post liberalization phase that has witnessed setting up the regulatory institutions as also enactment of new laws to regulate the capital market.
### 3.1. Appendix

#### Table 3.1: Evidence from short-run event studies

<table>
<thead>
<tr>
<th>Author(s) (year)</th>
<th>Period of study</th>
<th>Details o’ sample</th>
<th>Event window</th>
<th>Statistical Method</th>
<th>Main findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firth (1980)</td>
<td>1969–1975</td>
<td>642 takeovers</td>
<td>Announcement month</td>
<td>OLS Regression</td>
<td>Average cumulated residuals of ~0.045 during the announcement month (statistical significance not reported).</td>
</tr>
<tr>
<td>Dodd (1980)</td>
<td>1970–1977</td>
<td>151 takeovers</td>
<td>~40 to +40 days</td>
<td>OLS Regression</td>
<td>Acquirers lost by 0.23% (insignificant) at the announcement date from completed offers.</td>
</tr>
<tr>
<td>Bradley et al. (1983)</td>
<td>1962–1980</td>
<td>241 successful acquirers and targets, 94 unsuccessful acquirers</td>
<td>~20 to +20 days</td>
<td>OLS Regression</td>
<td>Unsuccessful acquirers gained, on average, 2.32% over ~20 to +1 day, but lost by 2.96% as soon as the offer failure is revealed (+2 to +20 days). Both statistically significant. Unsuccessful acquirers exhibited insignificant loss of 0.64% over ~20 to +20 day period.</td>
</tr>
<tr>
<td>Franks and Harris (1989)</td>
<td>1955–1985</td>
<td>1058 acquirers, 1898 target firms (all successful)</td>
<td>~4 to +1 months</td>
<td>OLS Regression</td>
<td>Acquirers earned around 1.2% average abnormal returns during the announcement month (significant). During the period ~4 to +1 month, acquirers gained between 2.4% and 7.9% depending on the abnormal returns measure (both significant).</td>
</tr>
<tr>
<td>Lang et al. (1989)</td>
<td>1968–1986</td>
<td>87 targets and acquirers from successful tender offers</td>
<td>~5 to +5 days</td>
<td>OLS Regression</td>
<td>Negative impact on acquirers returns when the offer is made by a low Tobin’s q company. Acquirers earned 0.8% from unopposed offers and lost by 0.14% from opposed offers (neither is significant).</td>
</tr>
<tr>
<td>Mitchell and Lehn (1990)</td>
<td>1980–1988</td>
<td>228 hostile targets, 240 friendly targets, 232 bidders</td>
<td>~1 to +1 days</td>
<td>OLS Regression</td>
<td>Abnormal returns of ~1.66% to acquiring companies that are restructured following the offer and 0.77% to acquiring companies that are not restructured in the post-offer period (both significant).</td>
</tr>
<tr>
<td>Lang et al. (1991)</td>
<td>1968–1986</td>
<td>87 targets and bidders from successful tender offers</td>
<td>~5 to +5 days</td>
<td>OLS Regression</td>
<td>Negative abnormal returns noticed in the range of 6% to 7% from single acquirer, opposed offers (significant). Insignificant abnormal returns to multiple, opposed offers.</td>
</tr>
<tr>
<td>Smith and Kim (1994)</td>
<td>1980–1986</td>
<td>177 acquirers and targets</td>
<td>~5 to +5 days</td>
<td>OLS Regression</td>
<td>Acquirers lost by 0.23% over ~1 to 0 days (significant)</td>
</tr>
<tr>
<td>Holl and Kyriazis (1997)</td>
<td>1979–1989</td>
<td>178 successful acquirers</td>
<td>0 to +2 months</td>
<td>OLS Regression</td>
<td>Negative abnormal returns of 1.25% to acquirers showed two months after the bid announcement (significant)</td>
</tr>
<tr>
<td>Author(s) (year)</td>
<td>Period of study</td>
<td>Details of sample</td>
<td>Event window</td>
<td>Statistical Method</td>
<td>Main findings</td>
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</tr>
<tr>
<td>Higson and Elliot (1998)</td>
<td>1975–1990</td>
<td>1660 acquirers and targets</td>
<td>0 to +3 months</td>
<td>OLS Regression</td>
<td>Insignificant gains noticed between announcements until completion. Negative acquirer returns of 1.70% (significant) from the acquisition of large targets (i.e. Greater than 25% of acquirer’s market capitalization).</td>
</tr>
<tr>
<td>Walker (2000)</td>
<td>1980–1996</td>
<td>278 acquisitions, 230 mergers, 48 tender offers</td>
<td>−2 to +2 days</td>
<td>OLS Regression</td>
<td>Negative market adjusted abnormal returns of 0.84% (significant). No significant abnormal returns based on the industry and size matched benchmark portfolios.</td>
</tr>
<tr>
<td>Sudarsanam and Mahate (2003)</td>
<td>1983–1995</td>
<td>519 listed acquirers</td>
<td>−1 to +1 day</td>
<td>OLS Regression</td>
<td>Acquirers noticed abnormal returns between −1.39% and −1.47% (all significant) using a variety of benchmarks.</td>
</tr>
<tr>
<td>Gupta and Misra (2004)</td>
<td>1980–1998</td>
<td>285 M&amp;A</td>
<td>−10 to +10 days</td>
<td>OLS Regression</td>
<td>Bidders lose a significant 1.57% over the −1 to 0 day period. Returns for the −10 to −2 days or +1 to +10 days are insignificant.</td>
</tr>
<tr>
<td>Song and Walking (2004)</td>
<td>1985–2001</td>
<td>5726 M&amp;A</td>
<td>−1 to 0 days</td>
<td>OLS Regression</td>
<td>Acquiring firms with a period of more than a year of ‘dormant’ offer activity received a positive abnormal return of about 1%. Acquirers with a ‘dormant’ period of less than a year earn insignificant returns.</td>
</tr>
<tr>
<td>Campa and Hernando (2004)</td>
<td>1998–2000</td>
<td>262 European M&amp;A</td>
<td>−30 to +30 days</td>
<td>OLS Regression</td>
<td>Regulated EU acquirers lost by 1.96% over 60 days around the offer announcement. Acquirers from unregulated industries did not earn significant returns for the same period.</td>
</tr>
<tr>
<td>Ben-Amar and Andre (2006)</td>
<td>1998–2000</td>
<td>238 M&amp;A by 138 Canadian companies</td>
<td>−1 to +1 days</td>
<td>OLS Regression</td>
<td>Acquiring companies earned 1.6% over 3 days.</td>
</tr>
<tr>
<td>Author(s) (year)</td>
<td>Period of study</td>
<td>Details of sample</td>
<td>Event window</td>
<td>Statistical Method</td>
<td>Main findings</td>
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<tr>
<td>Firth (1980)</td>
<td>1969–1975</td>
<td>642 takeovers</td>
<td>~48 to +36 months</td>
<td>CLS Regression</td>
<td>Average Abnormal returns noticed ~1.0% to unsuccessful and ~4.8% to successful bidders over 84 months around the announcement date (statistical significance not reported)</td>
</tr>
<tr>
<td>Asquith (1983)</td>
<td>1962–1976</td>
<td>285 takeovers</td>
<td>+1 to +240 days</td>
<td>CLS Regression</td>
<td>Average Abnormal returns lost by 7.2% to successful bidders and 9.6% loss noticed to unsuccessful bidders in the post-outcome period (both significant).</td>
</tr>
<tr>
<td>Bradley et al. (1983)</td>
<td>1962–1980</td>
<td>241 successful and 94 unsuccessful bidders</td>
<td>~6 to +60 months</td>
<td>CLS Regression</td>
<td>No significant gains shown to unsuccessful bidders over the period ~20 to +180 days following the bid announcement</td>
</tr>
<tr>
<td>Malaesta (1983)</td>
<td>1969–1974</td>
<td>256 acquiring firms</td>
<td>~60 to +12 months</td>
<td>CLS Regression</td>
<td>0.043% average abnormal return from ~60 months until the announcement month (significant). ~0.054% average abnormal return (significant) from month 1 after the offer until 6 months afterwards</td>
</tr>
<tr>
<td>Franks and Harris (1985)</td>
<td>1955–1985</td>
<td>105 bidders, 1898 target firms, all successful</td>
<td>0 to +24 months</td>
<td>CLS Regression</td>
<td>~12.6% significant average abnormal return from the market model +4.5% average abnormal return (significant) from the CAPM.</td>
</tr>
<tr>
<td>Limack (1991)</td>
<td>1977–1986</td>
<td>529 M&amp;A</td>
<td>0 to +24 months</td>
<td>CLS Regression</td>
<td>Insignificant ~1.66% from month 0 to 12 months after the offer and insignificant ~4.67% over 24 months (CAPM), ~5.55% (significant) after 12 months and ~14.95% (significant) after 24 months.</td>
</tr>
<tr>
<td>Agrawal et al. (1992)</td>
<td>1955–1987</td>
<td>937 mergers and 227 tender offers</td>
<td>0 to +5 years</td>
<td>CLS Regression</td>
<td>Abnormal returns of ~10.26% (significant) to acquirees 5 years following the offer. Mergers exhibited significantly negative abnormal returns of 10% while tender offers shown insignificant abnormal returns up to 5 years after the offer.</td>
</tr>
<tr>
<td>Gregory (1997)</td>
<td>1955–1985</td>
<td>420 JK takeovers with bid values &gt;£10 million</td>
<td>0 to +24 months</td>
<td>CLS Regression</td>
<td>Different benchmark methods controlling for companies size, risk and growth opportunities reveal significant abnormal returns from ~8.15% to ~11.25% over the 24-month post-acquisition period. Between 31% and 37% of companies earn positive abnormal returns.</td>
</tr>
<tr>
<td>Loughran and Vigh (1997)</td>
<td>1970–1989</td>
<td>434 mergers and tender offers</td>
<td>0 to +5 years</td>
<td>CLS Regression</td>
<td>Average acquirer lost by ~6.5% (insignificant) 5 years after the bid.</td>
</tr>
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<tr>
<td>Higson and Elliot (1998)</td>
<td>1975–1990</td>
<td>166 C acquirers and targets</td>
<td>0 to +3 months</td>
<td>CLS Regression</td>
<td>Noticed insignificant loss of 0.74% over +1 to +12 months, −0.14% after 24 months, +0.83% after 36 months (all insignificant).</td>
</tr>
<tr>
<td>Sudarsanam and Mahite (2003)</td>
<td>1983–1995</td>
<td>519 listed acquirers</td>
<td>+1 to +750 days</td>
<td>CLS Regression</td>
<td>Significant abnormal returns of between −8.71 and −21.89% (all significant) based on size and MTB ratio portfolio return adjustment, market return and mean adjustment.</td>
</tr>
<tr>
<td>Gregory and McCrriston (2005)</td>
<td>1984–1992</td>
<td>197 bids by UK acquirers on US targets, 97 bids by UK acquirers on EU targets and 39 bids by UK acquirers on targets from countries other than US or EU</td>
<td>0 to +5 years</td>
<td>CLS Regression</td>
<td>Significant abnormal return of −9.36 and −27% over years +3 and +5 respectively in the US. No significant abnormal returns from EU offers, but positive gain noticed from offers other than EU countries or the US.</td>
</tr>
<tr>
<td>Connet al. (2005)</td>
<td>1984–1998</td>
<td>131 cross border public targets, 1009 cross border bids on private targets, 2626 bids on domestic private targets</td>
<td>0 to +36 months</td>
<td>CLS Regression</td>
<td>Public domestic acquirers lost by 19.78% on average over 36 months. The BHAR returns are control company adjusted (matched by size and MTB ratios).</td>
</tr>
<tr>
<td>Alexandritis et al. (2006)</td>
<td>1991–1998</td>
<td>179 successful public acquiring firms</td>
<td>0 to +36 months</td>
<td>CLS Regression</td>
<td>Abnormal returns noticed between −0.55% to 1.02% (all significant) from the CAPM and Fama and French models. Both base on equally weighted and value weighted portfolios</td>
</tr>
</tbody>
</table>

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References


• Rizvi, Y. (2008), ‘Picking the flowers’; Acquisition, Strategy as a tool for survival and growth a research paper submitted to 11th Strategic Management Forum, IIT Kanpur.


