Executive Summary

Cross border mergers and acquisitions in the 1990s were driven by acquirers from the developed world, while emerging market firms played a passive role as targets. However the 2000's, saw a shift in the role of participants, with the entry of firms from emerging markets such as China, India, South Africa, Brazil and Malaysia as acquirers. In value terms, acquisitions by emerging market firms grew from a meagre 8% of worldwide cross border acquisition in 1990 to 29% in 2010 (UNCTAD, 2013). During this time, Indian cross border acquisitions grew from a modest sum of USD 23 million in 1990 to USD 26 billion in 2010 (UNCTAD, 2013). A few acquisitions by Indian firms such as the Tata-Tetley, Tata-Corus, and Hindalco-Novelis deals made international headlines causing researchers and practitioners to take note of the growing presence of Indian acquirers in the cross border mergers and acquisition market.

The increase in cross border acquisitions by Indian firms and their entry into the global acquisition arena raises several research questions on the strategic choices made by Indian firms and the outcome of these choices. What are the strategic forces that compel firms to make cross border acquisitions? Are firms that make cross border acquisitions different in terms of their firm, governance, and industry characteristics from firms that do not make acquisitions? What is the stock market reaction to acquisition announcement and does reaction differ depending on the nature of the firm and the type of deal? How do acquiring firms perform in the long run in terms of operating performance and stock market returns?

This research study examines the decisions made by Indian firms to grow through cross border acquisitions and analyzes the outcomes of these decisions. The decision of adopting a cross border acquisition strategy is explored in three phases; the first phase examines determinants of acquisition decisions, the next phase examines short term performance of acquisitions and the final phase examines the long term performance of acquisitions. Cross border acquisitions by Indian firms in the 2000s, during the period from 2002 to 2010, a period when India was going through a period of rapid growth forms the setting for this study.
For the purpose of this study, unique datasets are created with data drawn from Thomson Reuters Securities Data Corporation (SDC) data base and supplemented with financials information from Center for Monitoring Indian Economy - Prowess, and economic data from World Bank, United Nations Conference on Trade and Development, and Reserve Bank of India. The deal data comprises of 661 cross border deals and 991 domestic deals that took place during the 2002 to 2010 time frame.

Separate data sets are created to address the objectives of this study. A firm level data set is created to examine the determinants of acquisitions. This involves extraction of firm level variables for both acquiring and non acquiring firms from audited financials data base in CMIE prowess. This data set comprises 19,038 observations across nine years. The second data set involves computing stock market returns based on daily share prices. This analysis is at a deal level. Returns and stock market data is available and computed for 610 deals for three day returns and 603 deals for eleven day returns from the sample of 661 deals. The long term stock market study requires extraction and computation of returns based on monthly closing prices. This data set is also at a deal level and returns on 606 deals have been computed. The long term operating performance study requires the extraction of consolidated financials for acquiring firms three years post acquisition. This data set is at a firm year level and has been computed for 351 acquiring firms from the sample of 457 cross border acquiring firms.

The data is analyzed using a sequential Logit model to examine the strategic decision of a firm to undertake a cross border acquisition; the first stage model examines the decision to do a deal v/s no deal and the second stage model examines the decision to undertake a cross border deal rather than a domestic deal. Short term stock market reaction is examined using the event study methodology using a three day and eleven day event window. A cross sectional regression analysis is performed to examine the impact of firm and deal level variables on short term acquisition performance. Long term stock market buy and hold returns for twenty four months are computed for the event firm and compared with a portfolio of stocks matched by size and value. Long term operating performance for acquiring firms is measured by comparing with the median industry performance three years post acquisition announcement, and with acquiring firm performance one year prior to acquisition announcement using accounting based measures of performance.
The results on the study of determinants of acquisition decisions indicate that the acquisition strategy of Indian firms is driven by firm, industry and governance characteristics. Strategic forces such as level of competition in the industry, extent of ownership concentration, performance and age have influenced firms to undertake cross border acquisitions. Firms that are larger, younger, better performing, with more cash available and face a higher level of competition in the domestic market are more likely to acquire cross border targets. Promoters with high ownership stake deter firms from undertaking cross border acquisitions. Group owned firms are more likely to do a deal, but not a cross border deal.

After identifying characteristics of acquiring firms, the study next explores the stock market reaction to cross border deal announcements by firms. Results for the entire sample from 2002 to 2010 support the findings from literature that short term reaction to cross border acquisitions is positive. However, partitioning the data by economic cycle, the findings suggest that the results are driven by initial investor positive sentiments during the pre crisis period until 2007. The market reaction is significantly positive for the period up to 2007, however the market reaction turned cautious and negative for acquisitions announced after 2007. A cross sectional analysis of results also reveals that while larger sized firms are more likely to undertake cross border acquisitions, the market suspects that these acquisitions are driven by hubris or empire building motives and greets them with negative reaction. The market reacts positively to acquisitions that have more scope for synergies when acquirers and targets belong to the same industry.

In the final analysis, the study explores the long term stock market and operating performance of acquisitions to understand whether these inorganic growth strategies are value enhancing or destructive in the long run. Long term stock market buy and hold returns and operating performance results do not indicate any significant loss of value. Post acquisition operating performance of acquiring firms is not significantly different from the median industry performance or acquiring firm performance prior to acquisition announcement. Also, the long term buy and hold returns for the sample of acquiring firms is not significantly different from the performance of a matched portfolio of stocks for the same duration. However, a cross sectional analysis of buy and hold returns reveals a nuanced picture; larger firms earn lower long term buy and hold returns, while older firms and firms with larger promoter holdings earn significantly higher returns compared with a portfolio of matched firms.
To conclude, the study finds that firms that make cross border acquisitions have certain identifiable firm, industry and governance characteristics. Though, the stock market has turned cautious to cross border acquisition announcements in the recent years; the analysis of outcomes does not indicate a destruction of value in the long run. Firms contemplating cross border acquisitions can use the findings from this study to form an opinion on the likelihood of being successful in making cross border acquisition. While larger firms are more likely to be successful in making cross border acquisitions, they should be cautious in their approach in pursuing an inorganic cross border growth strategy, as the market is more likely to perceive that their strategy is driven from empire building or hubris motives. Though younger firms are more likely to pursue cross border acquisition strategies, these acquisitions may be value destructive in the long run. Promoters with high ownership concentration are less likely to pursue cross border growth strategies, however they have been more successful in enhancing firm value in the long run when they pursue cross border acquisition strategies.

This study fills a very significant gap in literature by exploring emerging market cross border acquisition decisions. It adds to the current literature on cross border acquisitions by analyzing the impact of firm and industry characteristics on the probability of choosing a cross border acquisition strategy over a domestic acquisition strategy in an emerging economy like India. The impact of competition, promoter holdings and ownership concentration on cross border acquisition decisions which have not been explored in the Indian context are analysed. The impact of factors that motivate acquisition decisions on acquisition performance in the short and long run which have been explored to a limited extent in literature are examined. Data from this research provides evidence on long run acquisition performance using both stock market and accounting based measures of performance using a large sample of deals and firms, thus contributing to the literature on cross border acquisitions which is at a nascent stage. This study also deals with methodology issues that have been pointed in literature but not dealt in the present body of literature on Indian cross border acquisitions.

The period of study covers the period when India liberalized its outward investment policy. Hence, it provides insights on how firms have responded to the policy initiatives taken by the government in opening up the Indian economy to outward FDI.
In addition to academia and policy makers, insights from this study provide useful inputs to managers as they make future strategic choices, and also to the investment community in analyzing acquisition decisions by firms.

This research pertains to one emerging economy, and could be extended further to other emerging markets such as China, Malaysia, the United Arab Emirates, Russia and South Africa to draw comparisons and inferences to see if the Indian experience is unique or similar to that experienced by other emerging markets. A case study based analysis using the data from this research could provide additional insights on inorganic growth strategies of emerging market firms. This study has examined the financial outcome of cross border acquisitions. Further research studies could be done to study the strategic outcomes of acquisitions.