Chapter 7

Some Concluding Observations

The economic reform programme and the new industrial regime implemented by the Government of India, our discussion suggests, enabled India’s business houses to undertake expansion either by entering into a new market or through expansion in an existing market without any restriction. In that process, mergers and amalgamations had a predominant role to play, resulting in an acceleration of the merger movement during the 1990s. The object of the present study was to examine the nature and significance of such mergers and their motives and consequences.

An analysis of the background leading up to the 1990s trend in mergers and acquisitions revealed that it had been used as one of the growth strategies by the Indian firms since seventies. During the period 1970-71 to 1990-91, the participation of non-MRTP companies was always greater than that of MRTP companies; although the involvement of MRTP companies in the merger movement was relatively higher in the eighties than in the seventies. Takeovers were another phenomenon which served as an instrument of growth in the private corporate sector in the late eighties as compared to the seventies; this was facilitated mainly by policy changes in the mid-eighties.

The merger movement appears to have been largely restricted to manufacturing firms. A majority of the acquiring firms belonged to the
manufacturing sector throughout our study period, although the number of amalgamations in the non-manufacturing sector has shown a sharp increase in the nineties. The overall involvement of private limited firms in the amalgamation process was also relatively lower than that of public limited firms during the period 1985 to 1995. However, the share of private limited firms has increased from 20 percent during 1985-1990 to 31 percent during 1990-1995. The evidence also shows, that the share of private limited firms involved in the merger process was higher in the non-manufacturing than in the manufacturing sector. This was possibly a consequence of the financial liberalisation of the 1990s, which forced financial firms to increase their competitive capacity and seek early listing in the stock market. The latter was necessitated by the tendency towards mergers by private limited companies with financial firms already registered in the market, in order to access the stock market and exploit the capital market boom through the private placement of shares.

When we measured the size of the merger movement in the nineties in terms of total paid-up capital, we found that the share of acquiring manufacturing firms in the paid up capital of all non-financial private corporate companies in India increased during 1990-91 to 1994-95. However, except for the year 1992-93, their share in total paid-up capital was minimal because these acquiring firms were small in size. From the categorisation of size-distribution, we found that one third of the sample acquiring manufacturing firms belonged to the large-sized group with an asset size of
Rs 100 crore and above. However, these firms accounted for 94.43 percent of the total asset of the sample of acquiring manufacturing firms. Many of these firms could have been characterised as MRTP firms, and could not have opted for the merger route to expansion if the government had not diluted the MRTP Act. Thus the removal of institutional entry barriers appears to have encouraged a few Indian and foreign firms to redefine their product portfolios and reformulate their corporate and business strategies through the merger process.

An analysis based on 45 major mergers which occurred among firms in the private corporate manufacturing sector in India during the nineties revealed that the acceleration of the merger movement in the 1990s was accompanied by the dominance of mergers between firms belonging to the same business group or house. Further, horizontal mergers dominated. More than 50 percent of the sample acquiring firms were involved in horizontal mergers. The rest of the sample acquiring firms were involved in vertical and conglomerate mergers. This composition leads one to believe that the merger movement would have contributed to an increase in product-wise concentration. However, since a large proportion of mergers were between related firms, it could be argued that while the merger movement may have contributed to an increase in product or asset concentration measured on a firm-wise basis, it could not have contributed to an increase in concentration as measured by the relative shares of business groups. Since business groups have for long been seen as representative unit of capital in India, it could be argued that the liberalisation-
induced merger wave of the 1990s did not have as its principal locomotive, the drive to reproduce and extend the bases of monopoly power of big capital in India.

The need for business groups to restructure themselves in the liberalised economic environment appears to be the real objective underlying the acceleration in mergers in the 1990s. If hitherto the business groups preferred to carry out similar or unrelated activities through the creation of a number of legally independent firms, there appears to be a change that occurred in the 1990s, with firms obviously preferring to integrate hitherto separate operations under a single legal entity.

One fifth of the sample acquiring firms were under foreign ownership. Foreign controlled firms began participating in the merger process after 1992-93, facilitated by the policy changes. As compared with the characteristics of merger involving Indian firms, these mergers were different inasmuch as they were all horizontal mergers between companies which were engaged in the same product lines. But, as in the case of mergers involving Indian firms, most of this firms acquired another firm belonging to the same management.

Acquisitions contributed significantly to asset-growth in only one fifth of the sample firms studied. During 1989-90 to 1994-95, most of the sample firms mobilised a large share of resources through capital markets, borrowing and current liabilities to finance their expansion. The relatively insignificant role of expansion as
an explanation for merger,ties in with our earlier understanding that mergers were more a means of internal restructuring than an instrument of further product market or asset share. Most of the acquiring firms paid dividends above 20 percent of their total earnings. Even low growth firms attracted investors by giving incentives in terms of large dividend as compared to the high-growth firms. High-growth firms also mobilised large share of resources from the capital market through share premium. This corroborates the finding that merger per se in the nineties was not a route to growth, which in fact was dominantly financed through resources acquired from a buoyant share market. The insignificant role of mergers as the means to expansion also suggests that the pursuit of size alone, with the aim, for example, of having a larger equity base on which to undertake borrowing, could not have been the determining stimulus for the merger wave of the 1990s.

The evidence suggests that the financial performance of the acquiring firms was relatively better than the performance of the overall manufacturing private corporate sector. A similar trend is noticed when we compare the financial performance of the acquiring firms with the large sized private corporate manufacturing sector.

A comparative analysis based on a set of firms (acquiring and acquired) revealed that the financial performance of most of the acquiring firms was relatively better than the acquired firms. From the comparison of the profitability ratio of the acquiring firms before and after merger, it emerges that 54 percent of the all
acquiring firms recorded an increase in the ratio of gross profit to net sales, but 64 percent showed a declining trend in the gross profit to total capital employed ratio. Thus the evidence on profitability is mixed, and in any case it is difficult to establish any causal association between the merger process and trends in profitability, since a whole range of other variables would have influenced the latter. There are, however, two other financial trends that lend themselves to a more definitive interpretation. To start with, the average gearing ratio for two years after as compared with two years before the merger, declined significantly in 69 per cent of cases in the sample. Secondly, the return on shareholder's equity (i.e., dividend/equity) also improved after merger in the case of 69 percent of the acquiring firms. These trends suggest that among the motives for merger in these cases could be the desire to improve the financial position of the firm through a viable capital structure. In return for this advantage, those in control of the firms' operations seem to be 'paying off' shareholders in the form of short term income gains so as to win their approval for the merger.

It is apparent that the shareholders of the most of the acquired firms derived significant financial benefits through the merger process either in terms of capital gain or in terms of rate of return or both, which possibly won their support for the merger. Further, as a result of acquisitions through merger, there occurred an increase in the equity share of the major controlling block in the acquiring firm after the merger in 18 out of 25 cases. In the remaining seven cases, where we observed a
reduction in the shareholding of the major controlling block, two were mergers between firms belonging to unrelated managements. This evidence suggests that one of the financial motives for merger and an explanation of why it occurs predominantly between related firms, could be the need for a particular management or the decision-making authority of a specific business group to increase its controlling block in order to guard against a take-over or a dilution of control either at given shareholding levels or at an enhanced shareholding resulting from a public issue. That is, the restructuring in response to the liberalisation occurs not only as a means of guarding against the threats and opportunities created by greater internal and external competition, but also in order to stave off the threat of a loss of control resulting from greater financial liberalisation and the desire of firms to exploit the opportunity provided by the immediate post-liberalisation buoyancy in Indian stock markets. The latter desire is amply illustrated by the evidence on the role of the capital market in financing expansion provided earlier.