CHAPTER THREE
REVIEW OF LITERATURE

3.1 Introduction:

Mergers and acquisitions are often viewed as the magic elixir that will grow sales, enhance prestige, and some save cost through synergies. However, mergers and acquisitions usually aren’t successful, cost more than projected, and demand so many resources that they distract from really effective activities like the Cost Reduction Strategy (Anderson, David; 2007).

Mergers and Acquisitions are considered to be very significant transactions, not only for the companies involved, but also for many other constituencies, such as managers, competitors, workers, economies, society and countries. Their success or failure has enormous consequences for creditors, stockholders and all the above mentioned stakeholders. Huge sums of money are involved in such activities. History is replete with examples of Mergers and Acquisitions which usually happened in waves. The most recent wave happened in the 1990s in the USA where the value of M&A deals rose from a mere US $ 200 billion in 1992 to US $ 1.75 trillion in 1999 before the markets crashed. Some of the largest deals in history were done during this period. America Online (AOL) acquired Time Warner for about US $ 165 billion in early 2000. However, two years later AOL had to write off nearly US $ 60 billion of the acquisition cost in goodwill write down and restructuring costs.

Europe also experienced a spectacular merger wave around the same time. In the year 1999, when the merger boom was at its peak, the value of deals rose to US $ 1.5 trillion. The largest acquisition in European corporate history was that of the UK mobile telephone company Vodafone’s hostile acquisition of Mannesmann, a German telecom company, in the year 1999. The deal value was over US $ 150 billion.

However, with the meltdown of the western stock markets in the early years of the twenty first century, acquirers in many of these deals suffered enormous losses. Shareholders also made huge losses on two fronts - losses due to fall of the stock prices and also losses due erosion of the value of the companies (Sudarsanam, 2009).

At present, dramatic growth in M&A activity can be observed across the globe. The period, between the years 1990-2000, was known as the wave of Mega
mergers in the USA, when the merger activity increased by 42 per cent from the previous decade (Machiraju, 2008).

Transactions worth $2608 billion were concluded globally in the year 2005 and the growth in Indian M&A activity rose by 87 per cent in 2005 which amounted to US $15.1 billion (The Financial Express, 2006).

Mergers and Acquisitions activity carries a cachet of mystique and glamour by reason of the headlines and business press comments which international mega deals attract. In the first half of 2006 M&A deals worldwide reached a record high of US $1930 billion including the exceptional period of the dot.com boom. (Jonathan Reuvid, 2007)

In 2007, India attracted deals worth US $68.32 billion, as compared to US $28.16 billion in 2006 and US $18.35 billion in 2005. (Chakrabarti, 2008)

Out of this, M&A accounted for US $51.17 billion while the remaining US $17.14 billion was in the form of private equity investment. There were 661 M&A deals, including 348 cross-border deals—240 outbound and 108 inbound (Prowess Database, CMIE).

A merger can change the lives of lots of people attached to the company as well as the stock markets in general. Merger/ Acquisition are important competitive strategies. Multibillion – dollar mergers can lead to ruthless games for money and power (Sangohee Sanjay).

Mergers and industrial restructuring has also raised some prominent issues for business decisions as well as for public policy formulation. Mergers and Acquisitions may be critical to the healthy expansion of business firms as they evolve through successive stages of growth and development. Internal as well as external growth is required for the long term sustainability of any business. Entering new product markets, geographical markets and new product development require the firm to undertake M&As at some point in the firm’s life. In order to remain competitive in international markets, a firm would have to obtain capabilities in a timely and efficient manner through the strategic tools of M&As. It has been argued that mergers increase value and efficiency and move resources to their highest and best uses, thereby increasing shareholder value.
However, there is wide scale skepticism surrounding this theory. The counter argument is that companies acquired are already efficient and that their subsequent performance after acquisition is not improved. Another school of thought avers that the gains to shareholders merely represent a redistribution away from labour and other stakeholders. One view is that M&A activity represents the machinations of speculators who reflect the frenzy of a “Casino Society” (Weston, Chung, & Hoag, 2007).

Even Warren Buffet has expressed skepticism of the power of Mergers. In the annual report of Berkshire Hathaway in 1981, this is what Warren Buffet (Warren Buffet, 1981) observed:

“General Acquisition Behavior

As our history indicates, we are comfortable both with total ownership of businesses and with marketable securities representing small portions of businesses. We continually look for ways to employ large sums in each area. (But we try to avoid small commitments - “If something’s not worth doing at all, it’s not worth doing well”.) Indeed, the liquidity requirements of our insurance and trading stamp businesses mandate major investments in marketable securities.

Our acquisition decisions will be aimed at maximizing real economic benefits, not at maximizing either managerial domain or reported numbers for accounting purposes. (In the long run, managements stressing accounting appearance over economic substance usually achieve little of either.)

Regardless of the impact upon immediately reportable earnings, we would rather buy 10 per cent of Wonderful Business T at X per share than 100 per cent of T at 2X per share. Most corporate managers prefer just the reverse, and have no shortage of stated rationales for their behavior.

However, we suspect three motivations - usually unspoken - to be, singly or in combination, the important ones in most high-premium takeovers:

1) Leaders, business or otherwise, seldom are deficient in animal spirits and often relish increased activity and challenge. At Berkshire, the corporate pulse never beats faster than when an acquisition is in prospect.

2) Most organizations, business or otherwise, measure themselves, are measured by others, and compensate their managers far more by the
yardstick of size than by any other yardstick. (Ask a Fortune 500 manager where his corporation stands on that famous list and, invariably, the number responded will be from the list ranked by size of sales; he may well not even know where his corporation places on the list Fortune just as faithfully compiles ranking the same 500 corporations by profitability.)

3) Many managements apparently were overexposed in impressionable childhood years to the story in which the imprisoned handsome prince is released from a toad’s body by a kiss from a beautiful princess. Consequently, they are certain their managerial kiss will do wonders for the profitability of Company Target. Such optimism is essential. Absent that rosy view, why else should the shareholders of Company Acquisitor want to own an interest in Target at the 2X takeover cost rather than at the X market price they would pay if they made direct purchases on their own? In other words, investors can always buy toads at the going price for toads. If investors instead bankroll princesses who wish to pay double for the right to kiss the toad, those kisses had better pack some real dynamite.

We’ve observed many kisses but very few miracles. Nevertheless, many managerial princesses remain serenely confident about the future potency of their kisses - even after their corporate backyards are knee-deep in unresponsive toads.

In fairness, we should acknowledge that some acquisition records have been dazzling. Two major categories stand out.

The first involves companies that, through design or accident, have purchased only businesses that are particularly well adapted to an inflationary environment. Such favored business must have two characteristics: (1) an ability to increase prices rather easily (even when product demand is flat and capacity is not fully utilized) without fear of significant loss of either market share or unit volume, and (2) an ability to accommodate large dollar volume increases in business (often produced more by inflation than by real growth) with only minor additional investment of capital. Managers of ordinary ability, focusing solely on acquisition possibilities meeting these tests, have achieved excellent results in recent decades. However, very few enterprises possess both characteristics, and
competition to buy those that do has now become fierce to the point of being self-defeating.

The second category involves the managerial superstars - men who can recognize that rare prince who is disguised as a toad, and who have managerial abilities that enable them to peel away the disguise. We salute such managers as Ben Heineman at Northwest Industries, Henry Singleton at Teledyne, Erwin Zaban at National Service Industries, and especially Tom Murphy at Capital Cities Communications (a real managerial “twofer”, whose acquisition efforts have been properly focused in Category 1 and whose operating talents also make him a leader of Category 2).

From both direct and vicarious experience, we recognize the difficulty and rarity of these executives’ achievements. (So do they; these champs have made very few deals in recent years, and often have found repurchase of their own shares to be the most sensible employment of corporate capital.)

Your Chairman, unfortunately, does not qualify for Category 2. And, despite a reasonably good understanding of the economic factors compelling concentration in Category 1, our actual acquisition activity in that category has been sporadic and inadequate. Our preaching was better than our performance. (We neglected the Noah principle: predicting rain doesn’t count, building arks does.)

We have tried occasionally to buy toads at bargain prices with results that have been chronicled in past reports. Clearly our kisses fell flat. We have done well with a couple of princes - but they were princes when purchased. At least our kisses didn’t turn them into toads. And, finally, we have occasionally been quite successful in purchasing fractional interests in easily-identifiable princes at toad-like prices.

Berkshire Acquisition Objectives

We will continue to seek the acquisition of businesses in their entirety at prices that will make sense, even should the future of the acquired enterprise develop much along the lines of its past. We may very well pay a fairly fancy price for a Category 1 business if we are reasonably confident of what we are getting. But we will not normally pay a lot in any purchase for
what we are supposed to bring to the party - for we find that we ordinarily don’t bring a lot.

During 1981 we came quite close to a major purchase involving both a business and a manager we liked very much. However, the price finally demanded, considering alternative uses for the funds involved, would have left our owners worse off than before the purchase. The empire would have been larger, but the citizenry would have been poorer.

Currently, we find values most easily obtained through the open-market purchase of fractional positions in companies with excellent business franchises and competent, honest managements. We never expect to run these companies, but we do expect to profit from them.

We expect that undistributed earnings from such companies will produce full value (subject to tax when realized) for Berkshire and its shareholders. If they don’t, we have made mistakes as to either: (1) the management we have elected to join; (2) the future economics of the business; or (3) the price we have paid.

We have made plenty of such mistakes - both in the purchase of non-controlling and controlling interests in businesses. Category (2) miscalculations are the most common. Of course, it is necessary to dig deep into our history to find illustrations of such mistakes - sometimes as deep as two or three months back. For example, last year your Chairman volunteered his expert opinion on the rosy future of the aluminum business. Several minor adjustments to that opinion - now aggregating approximately 180 degrees - have since been required. 

Hence, the dilemma that remains is – whether Mergers and Acquisitions are really an effective growth strategy. The review of literature has been undertaken to get some insight about the strategic perspective for Mergers and Acquisitions.

Two perspectives have been examined- One, in which the studies show that M&As create positive value for the firms or the shareholders and two, in which the studies defy the hypothesis that M&As create positive value for the firms or the shareholders.

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1 Warren Buffet’s letter to the shareholders of Berkshire Hathaway has been taken verbatim in order to retain the humour and candidness of expression.
3.2 Studies, which show, that Mergers/Acquisitions create positive value for the Firms/Shareholders:

A sample of 24 acquiring firms was selected from 3 industries - chemicals, machinery and electric utilities between the years 1961-1966. These classifications represent a wide range of operating environments, and each contains a relatively large number of non-merging firms used to predict non-merger performance of the acquiring firm. Analysis was done on the basis of comparing post merger returns with proxy returns if merger had not happened. The analysis found that the benefits were produced even though relatively large premiums were paid to the shareholders of the acquired firm proving that a high premium does not automatically imply an unsuccessful merger. Also, over 85 per cent of the mergers involved the exchange of common stock and/or cash so that it was unnecessary to use hybrid securities to produce the benefits. Under these conditions, the only remaining source of merger benefits is operating economies of some form. Thus, a well-conceived and executed merger is possible and will yield substantial benefits for the firm's shareholders (Shick & Jen, 1974).

A study conducted early on of 337 US mergers which included all firms listed in the Federal Trade Commission's major merger series for the period 1957-1975, with sufficient security returns data available to enable the required statistical calculations. The study utilized the Sharpe-Lintner capital asset pricing model as a statement of the equilibrium returns on risky assets, and also the Sharpe Single index model. It was observed that moderate gains are achieved by the buyer firms and substantial gains by the seller firms over the pre-merger period. The gains were fully impounded in trading prices about three months before the merger consummation date, and a small (statistically insignificant) wealth loss occurred over the ensuing three months. Conglomerate mergers showed superior wealth effects for both buyer and seller shareholders, compared to non conglomerate mergers. But if the assumptions of the CAPM are seriously violated concerning divisibility of investments or the ability of investors to borrow and lend at the risk-free rate), then no economic reward ensues from mergers undertaken (Elgers & Clark, 1980).

In 1981 a study was conducted to investigate the effect of merger bids on stock returns. Abnormal stock returns were examined throughout the entire merger process for both successful and unsuccessful merger bids. It was found that increases
in probability of mergers benefit the stockholders of the target firms, and that decrease in the probability of mergers harm the stockholder of both the target and the bidding firms (Asquith, 1983).

A study on the market for corporate control conducted in 1983 found that corporate takeovers generate positive gains for the target companies’ shareholders and the bidding companies’ shareholders also do not lose value. It was found that the gains that were created from corporate takeovers did not appear to come from the creation of market power (Jensen & Ruback, 1983).

M. Lubatkin (1987) studied samples of acquiring and acquired firms between the years 1948 and 1979 (acquisitions of at least $10 million in asset value) which were listed on the NYSE. Only complete acquisitions were studied.

Traditional and new market-model measures were used for the study and the results showed that mergers in general are a means to permanent gains in common stock value for both acquiring and acquired firms' stockholders.

Jarrel and Poulsen (1989) studied tender offers which took place in the US between the years 1963 and 1986 found that returns to acquirers at the announcement of takeovers are close to zero and negative in some cases. They have given three reasons for this:

First, the full wealth effects may not be observed in acquiring firm stock prices at the time of the bid because they are disguised in other information or are a relatively small component of acquirer wealth. Second, competition between alternative bidders ensures that any excess returns are earned by the targets. Third, the acquisitions are indeed poor investment projects for the acquirers and the wealth effects accurately reflect this.

A study of post acquisition operating performance of the 50 largest US mergers in the period 1979 to 1984 was conducted by Healy, Palepu and Ruback. The sample included cases in which two merging firms were classified as having high, medium and low overlap. Their sample also included a large number of oil firms that conducted mergers within the energy sector.

In the main part of their analysis, they determined the effect of the mergers on accounting variables. They garnered the accounting data from annual reports, merger prospectuses, proxy statements and analyst reports. They compared pro-forma
performance of the two combining firms in the five years prior to the merger with the actual performance of the merged entity in the 5 years after the merger. As a control for economic changes, they benchmarked the results to overall changes at the industry level.

Their study reported that operating cash flows for the merged firms increased relative to industry benchmarks. They also decomposed into cash-flow margin on sales and asset turnover. Their analysis concluded that the increase in cash flows was driven by an improvement in asset turnover for the merged firms.

They also related the operating improvements and the abnormal stock returns at the announcement of the mergers. They found that the combined stock returns at the merger announcement were positive for their sample. In regression analysis, they found that the cash flow improvements following the merger were positively and significantly related to the announcement stock returns (Healy, Palepu, & Ruback, 1992).

Tim Opler (1992) investigated the consequences of leveraged buyouts (LBOs) on operating performance using a sample of 44 going-private transactions of US based publicly traded companies listed in the 1990 Forbes Private 400 completed in the period 1985-1989. The LBOs in this sample were followed by significant increases in operating cash flow, suggesting that these transactions have yielded significant efficiency gains for investors. Increases in net cash flow were even higher.

One study conducted by Datta, Pinches and Narayanan (1992) analyzed the empirical literature concerning the influence of various factors on shareholder wealth creation in mergers and acquisitions using a multivariate framework. Overall, results of their study found that while the target firm's shareholders gain significantly from mergers and acquisitions, those of the bidding firm do not. Their findings also indicated that the use of stock financing had a significant impact on the wealth of both the target and bidding firms' shareholders. The presence of multiple bidders and the type of acquisition influenced the bidders' return, while regulatory changes and tender offers influenced the targets' returns.

Mergers and Acquisitions of European firms were studied in order to determine post merger change in performance. A regression analysis was conducted wherein post merger performance was the dependent variable and merger relatedness, age, cultural compatibility, autonomy removal and relative pre merger performance
were the independent variables. A significant variance was found in the post merger performance of the European firms (Veri, Lubatkin, Calori, & Viegga, 1997).

A survey of acquiring firm managers that covered 253 horizontal mergers and acquisitions that were initiated by European and U.S. firms in manufacturing industries for the period 1988–1992 was conducted. This study incorporated insights from the cost efficiency and resource-based theories to propose a model of the effects of asset divestiture and resource redeployment on long-term acquisition performance. Overall, the results showed that both asset divestiture and resource redeployment can contribute to acquisition performance, with, however, a significant risk of damaging acquisition performance when the divested assets and redeployed resources are those of the target (Capron, 1999).

A study examined acquisitions of American companies, completed between January 1, 1980 and December 31, 1996. The minimum deal size of each acquisition was US $ 50 million. The strategic objectives and stock price performance of acquiring firms were investigated. The results indicated that acquiring-firm shareholders earn higher returns following cash offers and also that acquiring-firm shareholders earn higher returns following takeovers that expand the firm's operations geographically or increase its market share. Further analysis found that shareholder losses are limited primarily to those takeovers based on diversification strategies, when the acquiring firm cited potential overlap with its existing operations (Walker, 2000).

Laurence Capron and Natalie Pistre (2002) tested the hypotheses that mergers create abnormal value to the acquirer and the target on a sample of 101 U.S. and European acquiring firms involved in horizontal acquisitions. They estimated the acquirer abnormal returns by using an event study, and assessed the source of synergies by measuring the extent and direction of post acquisition resource transfer to and from the target through a survey. It was found that the contribution of the acquirers’ resources is positively associated with acquirers’ returns, while the contribution of the target’s resources, in itself, does not generate acquirer returns.

It was found that acquirers do not earn abnormal returns when they only receive resources from the target. In this case, it is likely that multiple bidders, which could have equally captured these resources, competed away all the abnormal returns from the successful bidder. In contrast, it was found that acquirers can expect to earn
abnormal returns when they transfer their own resources to the target. Overall, it was found that value creation does not ensure value capture for the acquirer.

A study of the post merger financial performance of 162 merging firms that occurred during 1975-1990 in the US was conducted. Industry adjusted operating cash flow returns on market value of assets was used as the measure of performance. A significant increase of 12.7 per cent in firm performance after merger had taken place (Ramaswamy & Waegelein, 2003).

A cross sectional analysis of 54 US bank mergers between the years 1991 and 1995 came to find that upon announcement, the market rewards the mergers of partners that focus their geography and activities and earnings streams. Only one of these facets, focusing earnings streams, enhances long-term performance. Two other circumstances improve long-term performance: 1) when a merger involves a relatively inefficient acquirer and 2) when partners reduce bankruptcy costs (DeLong, 2003).

All complete acquisitions of publicly traded U.S. companies by publicly traded U.S. companies announced and completed between 1979 and 1998 from the Securities Data Company’s (SDC) Mergers and Acquisitions database were studied and the findings of the study were that combined abnormal returns are higher for acquisitions that occur at the beginning of acquisition waves. However, for acquirers’ returns, only strategic pioneers—those acting in manners consistent with having superior information—capture significant advantages. Specifically, early-mover acquirers who realize superior stock returns are those that conduct acquisitions in related industries, during industry expansionary phases, and finance their acquisitions as financial theory suggests they should when they possess an informational advantage—with cash (Carow, Heron, & Saxton, 2004).

In a study conducted by Patrick Beitel and Dirk Schiereck(2006) to examine the Value creation through cross border M&As of European banks, they came to the conclusion that shareholders of targets earn significant positive cumulated abnormal returns but the shareholders of the bidding banks do not earn any significant cumulated returns. It was found that there was no value creation on a net basis. However they can be termed as successful as M&As were found to be the simplest ways of large wealth transfer.
In order to maximize rewards to shareholders, a company must grow, and it can achieve this either organically or through mergers or acquisitions. The combination of two companies will almost immediately have an impact on the top line of a business, namely revenues (Simon Arthur, Horsey Lightly Fynn, 2007).

An analysis based on 162 mergers and acquisitions that took place between 2001 and 2003 among the listed Japanese companies. The concept of abnormal operating performance was used in order to measure the effect of mergers and acquisitions on the corporate performance of acquiring companies. Abnormal performance is calculated by taking the difference between the actual operating performance of firm ‘i’ between the period t and j and the expected performance of the firm ‘i’ between the period t and j. The expected abnormal performance is a sum of the past operating performance of firm ‘i’ (P_{i,t}) and the change in median performance of the companies in the comparison group for j periods from the period t (ΔP_{i,t+j}). Setting t as the previous year of the implementation of mergers and acquisitions, and j=1,2,3, abnormal performance (AP_{i,t+j}) signifies the sum of the abnormal performance of firm i for j years after the mergers and acquisitions. Three measures were used as proxies for abnormal performance namely net profits, operating profits and operating cash flows. For the comparison of pre and post merger operating performance, the Wilcoxon signed rank test was used. The study ultimately concluded that the overall effects of Mergers and Acquisitions on corporate performance are statistically insignificant compared to corporate performance of other companies within the same industry with similar pre acquisition performance.

Regression analysis was also conducted in order to determine which factors affect the post acquisition abnormal performance. The factors that were examined were financing methods, years, pre acquisition performance, firm size, industry growth and asset growth. Regression was run using the ordinary least squares method. The findings of the regression show that complete acquisition, smaller size and restructuring efforts may improve post-acquisition performance of the acquiring companies (Kawahara & Takeda, 2007).

A study conducted at IIM Calcutta of 87 pairs of merged firms for the period 1996-2002 out of which 64 were in related business and 23 were in unrelated business shows only a marginal growth of only 5.4 per cent in long term post merger performance that too only in the case of unrelated mergers. As far as wealth gains on
merger announcement were concerned, only the shareholders of the acquired firms appeared to be enjoying significant positive share price returns of 11.6 per cent. The shareholders of the acquiring firms and the combined firms did not seem to be witnessing any significant change in returns (Ramakrishnan, 2008).

A study of the merger of Centurion Bank of Punjab and HDFC Bank was conducted. The objectives of the study were:

- Identify the strategic reasons for the merger.
- To know the announcement impact of the merger on shareholders’ wealth of both, acquiring and target bank.
- To understand the immediate impact of the merger on fundamentals of the merged entity in order to discern how the probable synergies would impact the performance of the merged entity in reality.

The study was conducted in two parts; firstly, the announcement impact of the said merger on shareholders’ wealth of both acquiring and target bank was ascertained by using the event study method. And secondly, in order to understand the synergies between the two banks, various growth, profitability, efficiency and productivity ratios of the merged entity were compared to those of HDFC Bank.

The analysis came to the conclusion that the merger enabled the merged entity to enhance its size and the scale of its operations by providing a diverse range of products; and expand business reach through extensive branch network. The management of the merged entity has also strengthened. Due to the extensive branch network and product mix and management expertise HDFC Bank was able to achieve the projected cost savings and increase the profitability (Mann & Kohli, 2009).

An Empirical analysis was based on virtually the entire population of Swedish manufacturing firms and employees in 1985–1998 in order to assess the effects of M&As on firm performance, plant productivity, employment, compensation, and career development of workers. The study was based on six hypotheses:

1. Workers employed at plants that are destined to be sold earn higher compensation than comparable employees.
2. Plants that are sold experience a decline in employment relative to comparable plants that are not sold.
3. Employees changing jobs in the aftermath of an M&A experience higher earnings growth than employees who do not change jobs.

4. Plants that are sold experience an increase in average worker quality relative to comparable plants that are not sold.

5. Plants have low performance before an M&A relative to comparable plants.

6. Plants experience an increase in performance after an M&A.

Approximately 2.6 million workers, 16,000 plants, and 9,400 firms were observed each year. For each worker, data on earnings, gender, national origin, age, location, level and field of education was collected and—using five-digit Standard Industrial Classification (SIC) codes—industry. For each plant, data on output and inputs, that is, capital, labor, and materials, which allow to assess total factor productivity was collected. For each acquiring firm, there are two indicators of performance, profit (value-added per employee) and market share. Using these data, the following earnings equation at the employee level was estimated:

$$EARN_{chet} = \alpha + \sum_{l=1}^{12} \gamma_l M&A_t + \delta INDIV_{it} + \phi ESTABLISHMENT_{et} + \psi FIRM_{ft} + \lambda t + \varepsilon_{it}$$

$EARN_{chet}$ denotes the logarithm of annual earnings of individual ‘i’ working in establishment ‘e’ of firm ‘f’ in year ‘t’, $\alpha$ is an intercept, and $\sum_{l=1}^{12} \gamma_l M&A_t$ parameterizes the relationship to an M&A, using coefficients $\gamma_l$. INDIV_{it} refers to a set of individual-specific factors: gender, national origin, age, level and field of education, experience, and self-employment. ESTABLISHMENT_{et} is a set of establishment-specific characteristics: plant age, size (logarithm of employment), average wage, relative productivity (relative to other plants in the same industry), and five-digit SIC industry dummies. FIRM_{ft} refers to firm-specific characteristics: total employment, research and development (R&D) intensity, average wage, number of plants, and a dummy variable for whether the firm operates in diverse industries. $\lambda t$ is a year-specific fixed effect, and $\varepsilon_{it}$ is the remaining classical disturbance term (random noise). Total factor productivity was also estimated using profit, market share, output, employment, and earnings equations at firm and plant levels. Total factor productivity was assessed as:
Profit, market share, output, employment, experience, or education were assessed using

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\ln(Q_{ij}) = \alpha_{ij} + \beta_1 \ln(L_{ij}) + \beta_2 \ln(K_{ij}) + \beta_3 \ln(M_{ij}) + \sum_{t=1}^{12} \gamma_t \text{MA}_{ij-t} + \sum_{t=1}^{12} \delta_t \text{ND}_{ij-t} + \text{Age Dummies} + \text{Industry Dummies} + \text{Time Dummies} + \epsilon_{ij}
\]

where \(L_{ij}, K_{ij}, \text{and } M_{ij}\) are labor, capital, and materials, \(\text{MA}_{ij-t}\) are year-specific M&A dummy variables, \(\text{ND}_{ij-t}\) are ‘no-data’ dummies, and \(y_{ij}\) is profit, market share, output, employment, average worker experience, or average worker education for plant or firm ‘i’ in industry ‘j’ at year ‘t’.

Consistent with human capital theory, it was found that M&As enhance plant productivity, although they also result in downsizing of establishments and firms. Productivity rises more after partial acquisitions than after full firm acquisitions, while firm performance does not decline in the aftermath of these ownership changes. M&As also appear to have a positive impact on the careers of workers by improving the sorting and matching of workers and managers to firms and industries that best suit their skills. It was also found that plants involved in an M&A experienced an upgrading in the ‘quality’ of human capital. It was conclude that such transactions constitute a mechanism for improving the sorting and matching of plants and workers to more efficient uses (Siegel & Simmons, 2010).

A study conducted at the University of Hongkong analyzed M&As based on certain performance parameters such as firm size, technology, productivity and profitability. They found that prior to M&As and during post-merger period, acquirers perform better than targets, whereas targets perform better than non-participants. Better acquirers purchase better targets. The gap between an acquirer’s performance and its target’s performance is smaller in within-industry M&As than in cross-industry M&As. Firms with better performance prior to M&As are more likely to bring success to their M&As.

The data for the study was extracted from the Thomson Financial Securities Data for a period between 1991 and 2007. A pre and post merger study of the firms
was carried out. Mean analysis and regression analysis were used for the study (Liu & Qui, 2010).

### 3.3 Studies which show that Mergers/Acquisitions created no value or in some cases negative value for firms/shareholders:

A study conducted on around 157 Japanese companies between the period from January 1, 1977 through December 31, 1984 concluded that wealth of acquiring firms' shareholders had increased, but the gains are not statistically significant. For Japanese acquiring companies, the size ratio is inversely related to abnormal returns, as shareholders lose wealth in large-ratio mergers and gain significantly in small-ratio mergers (Pettway & Yamada, 1986).

A study conducted by Neely (1987) included 26 successfully acquired and acquiring banking firms for the 1979 through early 1985 period listed on the American Over the Counter Exchange, American Stock Exchange and New York Stock Exchange. Five of the target banking firms were organized as banks and 21 are bank holding companies. All the acquirers were bank holding companies.

Small abnormal returns for both acquirers and targets occurred as early as 10 weeks and 7 weeks, respectively, before public announcement of bank acquisitions. For the two weeks before announcement the target return was over 9 per cent. Very large abnormal returns occured for targets during the announcement week. The large abnormal return during the announcement week was followed by a significant return for week + 1, and there was a positive cumulative abnormal return for ten weeks after announcement. There appeared to be an upward drift in targets' abnormal returns during the period between announcement and consummation as the events that lead to completion of the acquisition unfolded, although the regulatory approval event did not appear to affect the abnormal returns of targets. Acquirers' returns were slightly negative during the acquisition announcement week, but the CAR for the two weeks following announcement was slightly positive. A similar pattern of returns resulted from the regulatory approval announcement. Neither event appeared to cause significant effects on acquirer returns. So ultimately, the study came to the conclusion that abnormal returns occurred to the target company but not to the acquiring company.
Philippe Haspeslagh and David Jemison published a paper in 1987 in which they made certain profound observations about acquisitions in general. They found that the riskiness of acquisitions as a vehicle for corporate renewal is reflected in both empirical studies of acquisition results and managers’ comments about their experiences. Although many factors contribute to acquisition performance, a variety of recurring patterns in the acquisition process offers clues to the disappointing results. As a result of their extensive study, they made six observations:

1. Acquisitions don’t succeed…acquisition strategies do.
2. Shareholders are the least important constituency.
3. Managers try to capture rather than create value.
4. Strategic analysis plays only a small role in successful acquisition strategies.
5. Nothing can be said or learnt about acquisitions in general.
6. Companies do not learn all they could from their mistakes.

These six observations bust some of the popular myths associated with acquisitions. Two extreme views emerge from the myths about acquisitions. One suggests that acquisitions are a ready-made solution to managers’ problems. The other suggests that shareholders of acquiring firms never benefit from acquisitions. The researchers believed that none of the above views is true and together they have the potential to impede the management’s attempt to provide realistic corporate restructuring opportunities to the firm. The first misguided view is that the acquisition by itself can offer immediate and sweeping solution to a firm’s problems of strategic redirection. This has been refuted by the researchers. Acquisition would work if they are viewed as strategies and when the acquisition process takes into consideration the specific circumstances of the target and the acquiring firms. What this means is that acquisition methodology shouldn’t be standardized but it should be viewed as a customized strategic process for the company under consideration.

The other viewpoint that acquisitions are essentially driven by managerial motives and never benefit the acquiring companies’ shareholders is also not entirely correct. The authors argue that the real payoff comes from the value creation process that often takes several years to unfold. This means that the outcome of any acquisition deal can never be predicted in exactitude and will depend upon post merger integration process (Haspeslagh & Jemison, 1987).
It has been found that soft issues such as governance, leadership of the new organisation and cultural assimilation are the major issues which need to be addressed for the success of any merger or acquisition (Kazemek, 1989).

Using a data on 2732 lines of business operated by US manufacturing corporations, a study analysed the pre-merger profitability of acquisition targets and post merger operating results for the years 1957-77. Regression analysis and matched pre Vs. post merger analysis was carried out. Two hypotheses were tested in this study:

1. That acquired companies are profit under-performers.
   No broad statistical support was found for the above hypothesis.
2. Mergers improve profitability on an average.
   It was found that seven or eight years on average following merger, acquired units’ profitability had declined sharply relative to pre-merger levels.

The study basically found evidence that mandated considerable skepticism toward the claim that mergers on an average are efficiency increasing (Ravenscraft & Scherer, 1989).

A study of 115 global mergers in the mid 1990s showed that the total return to shareholders (relative to peer companies) was minus 58 per cent (Kearney; 1990).

Another study, the sample for which, included 10,837 acquisitions consummated in 1966-1984 of domestic firms in the USA which were listed on the New York Stock Exchange or the American Stock Exchange found that overall, restructuring activities such as mergers and acquisitions fail to create shareholder value. For the preacquisition period, the market model is estimated using data from the 200-day interval preceding event day -300, where day 0 is the offer announcement day. Firms with fewer than 100 observations were excluded from the analysis. Using ordinary least squares estimates of \( i_c \) and \( R_t \) (\( a_i \) and \( b_i \)), abnormal returns were computed as

\[
AR_{i,t} = R_{i,t} - (a_i + b_i R_{m,t})
\]

From this study it was found that, although stockholders benefit from the acquisition of individual production factors, they do not benefit from the acquisition of established firms. The profitability question of the acquisition of established firms
was reexamined with a large sample of transactions, widely defined to include mergers, tender offers, acquisitions of privately held firms, and comprehensive acquisitions of other firms' assets. According to the results, the majority of corporate acquisitions benefit the bidding firms' stockholders, a conclusion that was confirmed when controlling for relative acquisition size and partial anticipation. Large firms, for instance, seem to pay too much for their targets, and large bids seem to be overpriced on average. These effects were strong enough that, in the aggregate, corporate acquisitions appeared to have reduced shareholders' wealth (Loderer & Martin, 1990).

A Thomson Financial/First Call study commissioned by the Wall Street Journal study found that the stocks of the top 20 acquirers in the United States in the late 1990s have fallen nearly twice as much as the Dow Jones Industrial Average and the Standard & Poor’s 500 Index.

A study sponsored by the society for Human Resource foundation found a direct correlation between Human Resource involvement and M&A success. The survey conducted for four months in the year 2000, reflects a data of 447 employees wherein the participants were from North America, Europe, Latin America and Asia (Jeffrey A. Schmidt, 2002)

The odds are not favorable for success of mergers and acquisitions. According to KPMG research, only one in five deals lives up to its expectations. Time and cost estimates are usually unrealistic; as usually mergers cost twice the initial estimate put by the companies and the completion process takes double the amount of time (Fields & Lyz, 2003).

A sample of 552 publicly traded firms in the US that announced asset purchases was examined. The minimum deal size was $100 million. It was found that the announcement period returns were negatively related to the amount of free cash flow for buyers with fewer growth opportunities. As compared to the year prior to the purchase, the mean long-run operating performance of asset buyers worsened in each of the three years following the transaction. Operating performance changes were found to be negatively related to the amount of free cash flow, and the relationship was stronger for buyers with fewer growth opportunities. It was found that buyer firms experienced a decline in the return on assets and asset turnover ratios (Freund, Prezas, & Vasudevan, 2003).
The long-term performance of 267 Canadian mergers and acquisitions that took place between 1980 and 2000, using different calendar-time approaches with and without overlapping cases was studied. The results suggest that Canadian acquirers significantly underperform over the three-year post-event period. Further analysis shows that the results are consistent with the extrapolation and the method-of-payment hypotheses; that is, glamour acquirers and equity financed deals underperform. It was also found that cross-border deals perform poorly in the long run (Andre, Kooli, & L'Her, 2004).

Mergers and acquisitions have become inevitable parts of corporate restructuring after LPG. However, many empirical studies show that quite often mergers and acquisitions fail to create value for the shareholders of acquiring company. Causes of failure are size issues, lack of experience on part of acquiring firm, inefficiency, poor organization, cultural or strategic fit, overpaying, hubris on part of managers, failure to evaluate financial position, lack of due diligence, incompatibility of partners, lack of communication or leadership to name a few (T.Mallikarjunappa, Nayak Panduranga 2007).

The key principle for the buyer in an acquisition is that it should have a full and explicit understanding of the business it is acquiring. Hence the due diligence procedure is of utmost importance before taking the decision regarding the merger. However, most of the times this procedure is brief led and hence the viability of the synergy between the buyer’s business and the target cannot be properly established. In such a case there is a real danger that the target’s business is not fully understood at the operational level and a successful post deal integration plan may not be easily implemented (Simon Arthur, Horsey Lightly Fynn, 2007).

In case of businesses such as IT where intangible assets form a major chunk of the balance sheet, the transfer of such assets in case of mergers is not easy. A formal agreement has to be made for patents, trademarks and this agreement must be registered with an appropriate body. The target company’s contracts are also intangible assets which are made of both rights and obligations. Most companies would have hundreds of small and big contracts. Hence, the merger process of such companies becomes a lengthy and tedious one (David Wilkinson, Field Fisher Waterhouse, 2007).
Seventy five percent of all merger and acquisition deals do not meet the expected results (Kummer, 2008). Fifty to eighty percent of all merger deals fail because of an inability to integrate people into a cohesive new entity. When the collective identity of the organization is challenged, the post merger trauma can be significant to employees and managers (Riesenmy & Carr, 2008).

Mergers lead to anxiety amongst the employees wherein there develops an environment of distrust towards the management. Many employees choose to leave and turnover, especially in the middle management, increases. As turnover increases, more and more networks of relationships within the organisation and with customers are disrupted. This may lead to loss of business and reduced effectiveness in the company (GLS CONSULTING, INC).

The biggest challenge for the acquiring company is thorough human-capital due diligence. This would include gathering of information regarding the talents of management and key people, organisational design, workforce, remuneration and industrial relations of the company which is being acquired (Kummer, 2008).

Human resource management is the most difficult task in a merged firm. According to Mr. Dhirendra Shantilal (senior vice president APAC, Kelly services), the biggest challenge for a firm after merger is related to communication, compensation and talent management, culture and managing uncertainty. The merging firm needs to thoroughly assess the culture of the target organization and map policies accordingly.

When Jet Airways took over Air Sahara in April 2007, competitors were apprehensive about the success of this acquisition. There were a lot of grey areas in the deal which led to the withdrawal of Jet at one point. However, the deal was completed later after a lot of contemplation since the financial accounts of Air Sahara were not transparent. However after the deal, Jet Airways became the largest airline in the country with a fleet size of 80 and the total market share was likely to rise from 50 per cent to 80 per cent. However with the aviation industry in such turmoil, it cannot be said with confidence that the merger has reaped any positive benefits. (Taunk & Kulkarni, 2009)

This study was motivated by the inconclusive results of the past evidence. After reviewing several studies and corporate literature, one can still not come to a
conclusion regarding the exact outcome of any merger transaction. Very few past studies have incorporated Indian companies. This study is an endaevour to further the understanding of the rationale behind Mergers in the Indian context.