# Value Creation through Mergers and Acquisitions –A Review of Existing Literature

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*Mergers and Acquisitions have been the area of strategic focus for many corporate from last two decades. It is now a global growth strategy to serve a variety of firm specific objectives like accessing new markets, foreign strategic assets, trade and supporting infrastructure and shareholder's value creation. The Present paper deals with the objective of reviewing the empirical literature related to various motives behind domestic as well as cross border M&A's and also to investigate that whether these deals are resulted into value creation for the shareholder of acquirer or target firms with various M&A deal characteristics.*

**Keywords:** Domestic Versus Cross Border M&A's, Cross Border Inbound, Cross Border Outbound, Shareholder's Wealth, Event Study Methodology, Market Model

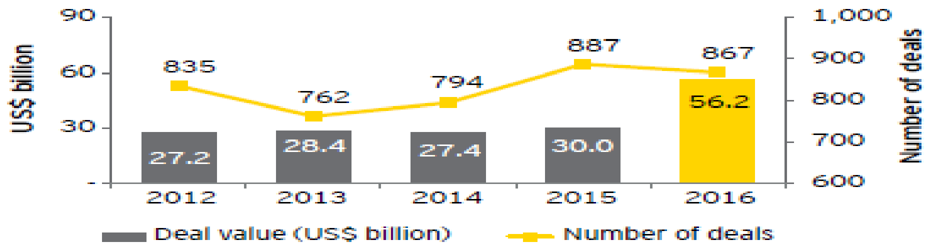
## 1. Introduction

The wave of Mergers & Acquisitions has started in latter half of the 1990 and has continued in the till this time. It is now becoming a mega activity due to globalization as both the value of deals and the number of deals have surged that is why the current M&A activity is far from being a unique phenomenon {(Ali-Yrkkö, Jyrki (2002)}.The cross-border deal activity has also seen an increase despite global shakeups, such as Brexit and policy uncertainty in the US that impacted global currencies and capital markets (E&Y, transactions 2017). Emerging market firms are strongly involved in the Cross Border M&A activity, their role is transferred from becoming a target to acquirer. "The hunters are fast becoming the hunted in the race for cross-border transactions between emerging and developed markets" (KPMG Emerging markets international acquisition tracker).

**M &A Activity of Indian Corporate:** M&As have become an integral part of the Indian economy as the Indian Economy is on a growth path, with the M&A trend likely to continue. There are various catalyst for expansion for firms in India: organic as well as Inorganic growth, but inorganic growth through M&A is on top of the agenda. This is because of the Indian Government's efforts to improve ease of doing business in India, the gestation period for green field projects continues to be long & predominance of various compliances with multiple regulations and other catalysts are Consolidation, sale of non-core assets mainly to reduce debts, shareholder activism, tax concerns & Funding Restrictions etc. (PWC report on, "Mergers & Acquisition, the evolving Indian landscape"). India is at the top of the Emerging Consumer scorecard, indicating a robust level of income expectations by the consumer and making India stand out in the emerging world as per the Credit Suisse Emerging Consumer Survey 2016.
According to Earnest and Young transaction survey 2017, the year 2016 witnessed the highest number of M&A deals **(Exhibit 1)** in India according deal value and deal count after the year 2010 and this year was regarded as the year of Mega deals and majority of these deals were domestic in nature. **The exhibit 2** shows the five most active sectors in India as per deal value in the previous year 2016 and **exhibit 3** shows the five most active sectors in India as per deal count in the same year. The figures suggest that oil and gas sector was an attractive sector in 2016 and Technology sector was that sector in which there were highest number of deals as digitization and disruptive technologies are driving the new wave for M&A in India.

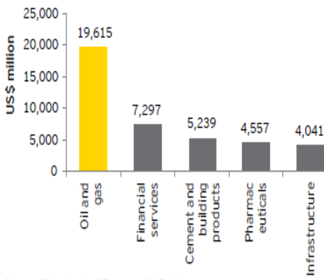
**Past Trends of M&A in India**

**Exhibit 1: M&A activities of Indian companies**



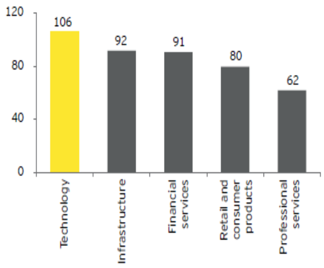

Source: EY analysis of Thomson ONE data

Exhibit 2: Five most active sectors by deal value in 2016




Source: EY analysis of Thomson ONE data

Exhibit 3: Five most active sectors by deal count in 2016



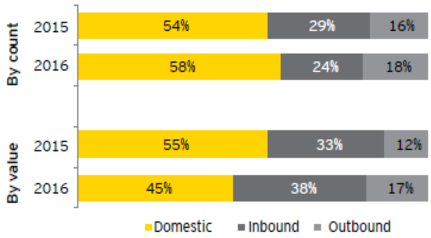

Source: EY analysis of Thomson ONE data

**Exhibit 4: Geographical distribution of deals**

| | 2015 | | 2016 | |
|---|---|---|---|---|
| | Count | Value (US$ million) | Count | Value (US$ million) |
| Domestic | 483 | 16,360 | 505 | 25,141 |
| Inbound | 258 | 9,949 | 204 | 21,396 |
| Outbound | 146 | 3,708 | 158 | 9,650 |
| **Total** | **887** | **30,017** | **867** | **56,187** |

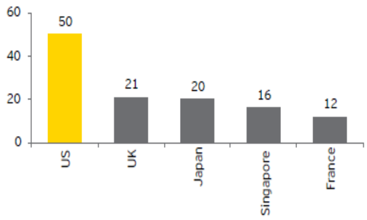
Source: EY analysis of Thomson ONE data

**Exhibit 5: Geographical spread of deals in 2016**



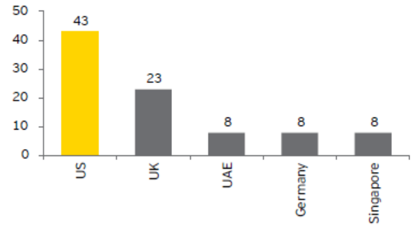

Source: EY analysis of Thomson ONE data

Exhibit 6: Five most acquisitive nations (in terms of volume) of Indian companies in 2016




Source: EY analysis of Thomson ONE data

Exhibit 7: Five most targeted nations by Indian companies in 2016




Source: EY analysis of Thomson ONE data

After looking on these trends it is very important to understand the motives behind M&A's and their performance implications in terms of value creation for shareholders and also it has been the area of considerable interest to researchers over the last two and a half decades. Despite the fact that M&A's have a long history, these two main questions need to be addressed again & again with the passage of time because of the reasons:

Firstly the motives behind M&A's are dependent on nature of the deal whether it is a domestic deal or a cross border deal? And secondly whether these deals are resulted in to long term value creation for the acquirer (bidder) and its shareholders as well as target and its shareholders.

## 2. Theoretical Explanation

**Corporate Restructuring** is concerned with arranging the business activities of the corporate as a whole so as to achieve certain predetermined objectives at corporate level. Such objectives are orderly redirection of the firm's activities, deploying surplus cash from one business to finance profitable growth in another, exploiting inter-dependence among present or prospective businesses within the corporate portfolio risk reduction and development of core competencies. One of the strategies of corporate restructuring is expansion through inorganic route like Mergers and Acquisitions. **A merger** is a deal to unite two existing companies into one new company and **an acquisition** is a corporate action in which a company buys most of another firm's ownership stakes to assume control of it. An acquisition occurs when a buying company obtains more than 50% ownership in a target company. As part of the exchange, the acquiring company often purchases the target company's stock and other assets, which allows the acquiring company to make decisions regarding the newly acquired assets without the approval of the target company's shareholders. So a merger is friendly in nature and acquisition can be both friendly as well as hostile in nature. Both are commonly done to expand a company's reach, expand into new segments, or gain market share with a hidden objective of share holder value creation.

**Cross-Border Structuring:** with increased collaboration with different countries, emerging market economies are expecting more and more business transactions. Multinationals are looking at these economies as their new growth engine, and various corporate houses of these economies especially Indian companies are consolidating their Indian operations and at the same time, looking to expand their global footprint. Against this backdrop, structuring cross-border transactions (i.e. inbound and outbound transactions) from the tax and regulatory perspective becomes a critical component to ensure that the structure is regulatory compliant and yields optimum returns to the organization and investors.

**Studies Related to Factors behind Domestic as well as Cross Border Mergers & Acquisitions**

Extensive Literature is there which suggests the various motives behind domestic as well as cross border mergers & acquisitions deals by corporate. B. Rajesh kumar & Prabina Rajiv (2007) have done the research on characteristics of merging firms in India and concluded that the lesser the liquidity position, greater the probability of a firm becoming a target & the larger firms are less likely to become acquisition targets. The authors found that the acquirer firms have higher cash flow, higher PE ratios, higher book value, higher liquid assets, and lower debt to total assets ratio, which are statistically significant when compared to the target firms. Parama Barai & Pitabas Mohanty (2012) built a prediction model for acquisition targets in India using logistic regression and concluded that a typical target is inherently strong with high growth and large free cash flow, in spite of high debt levels, but encumbered by an inefficient management, who are probably disciplined by takeover market. Charu Banga & Amitabh Gupta (2012), identified expansion of marketing and management capabilities, expansion of asset size, and benefits of diversification as most important motives behind mergers and takeovers of mutual fund schemes by conducting a survey of 65 fund managers through a questionnaire containing fifteen statements. Like domestic acquisitions, there are various studies which are focusing on trends, patterns and locational determinants of Indian overseas acquisitions by Indian companies. Indian multinationals have increasingly started adopting acquisition as a global growth strategy to serve a variety of their firm specific objectives like accessing new markets, foreign strategic assets, and trade and supporting infrastructure (Jaya Prakash pradhan (2007)). Beena Saraswathy (2010) & ROBERT S. HARRIS and DAVID RAVENSCRAFT (1991) examine the role of mergers and acquisitions of service sector on world FDI and concluded that a substantial proportion of FDI came through this route in recent period & costs and imperfections in product markets play an important role in bringing foreign direct investment in a host country. Dipali Krishna kumar (2011) in her working paper tries to examine the effect of deal financing structure, acquisition premium, corporate governance scores, board composition, human development index, firm size on acquisition performance of acquiring firms indulging in to cross border acquisitions. Value creation, managerial self-interest, environmental factors, and firm characteristics as the main reasons that firms make acquisitions (Haleblian, J., Devers, C., McNamara, G., Carpenter, M. and Davison, R.(2009)). Trahan (1993) identified five primary financial characteristics that motivate firms to make acquisitions namely 1) debt capacity , 2) firm size – measured by total sales, 3) management performance 4) free cash flows & 5) growth ratio – low growth firms may seek to grow through an acquisition. Huyghebaert & Luypaert (2010) study the antecedents of acquisitions for Belgian firms including firm characteristics, industry and financial market variables. They study characteristics that prompt firms to undertake acquisitions measured by variables measuring managerial motives and governance, market power, concentration, financial market conditions. Efficiency theory views mergers as being planned and executed to achieve various synergies like financial synergies, operational synergies and Managerial synergies (Friedrich Trautwein (1990)). Pradhan, and Abraham, (2004) analyzed cross border acquisitions by Indian firms from 2000 to 2003 using four variables export orientation, size, profit, R&D intensity. Jaya Prakash Pradhan (2007) in his working paper, "Trends and Patterns of overseas acquisitions by Indian Multinationals", identified that Indian overseas acquirers possessed a set of diversified motivations from market entry to the acquisition of firm specific strategic assets, to reap operational synergies and to overcome limitations of home country market. He also suggested that host country market characteristics such as gross domestic product/population and per capita GDP act as pull factors for FDI inflows into host countries.

## 3. Summary of Determinants for Mergers & Acquisitions

| | **Domestic Mergers & Acquisitions** | **Cross Border M&A Inbound and Outbound** |
|---|---|---|
| Motives/determinants for Mergers & Acquisitions for Acquirers as well as targets | • Higher cash flow, Higher PE ratios, higher book value, higher liquid assets, and lower debt to total assets ratio motivate the Acquirer for M&A<br>• Management capabilities, Expansion of asset size, and Benefits of diversification<br>• Value creation, managerial self-interest, environmental factors, and firm characteristics<br>• Debt capacity, 2) firm size – measured by total sales, 3) management performance 4) free cash flows & 5) growth ratio – low growth firms may seek to grow through an acquisition.<br>• Managerial motives and governance, market power, concentration, financial market conditions.<br>• High growth and large free cash flow & an inefficient management (for targets) | • Accessing new markets, Foreign strategic assets, and trade and supporting infrastructure.<br>• Costs and imperfections in product markets.<br>• Export orientation, size, profit, R&D intensity.<br>• Market Entry and limitations of home country market, operational synergies and per capita GDP of host country as a major explanatory factor behind overseas Acquisitions. |

As from the review of existing literature it can be analyzed that firm specific factors like key accounting Ratios, Managerial motives, shareholder value creation & general conditions like environmental factors are the major determinants of domestic Mergers and Acquisitions. Host country characteristics like GDP, Per capita Income and limitations of home country market play an important role behind cross border (inbound and outbound) M&A.

**Studies Related to Announcement Effects of Mergers & Acquisitions on Acquirer's and Target Shareholder's Wealth**

**Shareholder value** is the value delivered to shareholders because of management's ability to grow sales, earnings and free cash flow over time. A company's shareholder value depends on strategic decisions made by senior management, including the ability to make wise investments and generate a healthy return on invested capital. If this value is created over the long term, the share price increases and the company can pay larger cash dividends to shareholders. The two set of hypothesis in the theories of value creation by Mergers & acquisitions are examined by various studies 1: Value maximizing Hypothesis and Non Value Maximizing Hypothesis. The former suggests that acquisitions are motivated by maximizing the value of firm and whereas latter propose that mangers of bidding firms embark on acquisitions to maximize their own utility at the expense of stockholders. (Anju Seth 1990) M& A also create net new wealth from operating or financial synergies, or they redistribute existing wealth between stakeholder classes. (Carlos P. Maquieira et. al.1997). There can be differences in shareholder wealth due to various factors/characteristics of deal like regulatory changes, the number of bidders, the bidder's approach (i.e. merger vs. tender offer), the mode of financing (i.e. cash vs. stock), and the type of merger or acquisition (i.e. conglomerate vs. non-conglomerate) ( DEEPAK K. DATTA et al. (1992))

An event study methodology is a macroeconomic tool which is being used by various studies to see the impact of an event/announcement on shareholder's wealth. The market model is the most common analysis used for event study methodology. The idea is: if the same type of model is used to analyze multiple events of the same type, it can predict how stock prices typically respond to a specific event like announcement of M & A deals. The market model relates the return of a security to the return of the market portfolio as per the following equation: $Rjt = \alpha j + \beta mt + \varepsilon jt$, where Rjt is return from Individual securities and $\alpha j$ is the intercept and $\beta mt$ is market sensitive return.

Deepak K. Datta and George E. Pinches (1992**)** suggests that the event study approach is based on the hypothesis that in an efficient market the immediate wealth effect reflects the capital market's overall unbiased assessment of the present value of the future benefits of the merger or acquisition. Richard Roll (1986) has done the empirical research to develop the hubris hypothesis which tries to explain why bids are made even when a valuation above the current market price represents a positive valuation error. Reena kohli & Bikram Jit Singh Mann (2011), has examined the acquiring company announcement gains, and determinants thereof, in domestic and cross border acquisitions in India with the sample of 268 acquisitions comprising of 202 cross border acquisitions and 66 domestic acquisitions using standard event study methodology and concluded that that cross border acquisitions have created significantly higher wealth gains than the domestic ones. Cumulative abnormal returns (CARs) in the case of cross-border acquisitions are permanent, while in the case of domestic acquisitions they are temporary. (Neelam Rani et al (2015)). The research suggests that an investor can also earn substantial returns if the shares of the acquiring company are purchased two days prior to the announcement day and sold two days after the announcement day. Kathleen Fuller et al (2002), indicate that bidder shareholders gain when buying a private firm or subsidiary but lose when purchasing a public firm. In addition, they concluded that the gain or loss is greater in absolute value when the target is larger and when the bidder (acquirer) uses stock. Steven J, pill off and & Anthony M. Santomero on the basis of review of literature concluded that value of bank mergers and acquisitions presents a clear paradox and indicate clearly on the basis of review that on average there is no statistically significant gain in value or performance from merger activity. Acquired firm shareholders gain at the expense of the acquiring firm. Anju Seth (1990) in her work concluded that related acquisitions do not outperform than unrelated acquisitions and unrelated acquisitions create significant synergies in the long run. Glamour acquirers and equity financed deals underperform & cross border deals perform poorly in long Run (Paul Andre et. al, 2004). David King et al (2004) has analyzed the performance estimates of acquiring firms over a series of event windows (Days 1–5, Days 6–21, Days 22–180, Days 181 to 3 years, and greater than 3 years) that is for shorter as well as longer period and concluded that after the Days 1–5 event window, all of the 'abnormal returns' results for the acquiring firms are negative includes results for an acquiring firm's accounting figures like ROA, ROE) Collectively, these results imply that anticipated acquisition synergies are not realized by acquiring firms. The result is, M&A activity does not create superior post-acquisition performance for acquiring firms and is consistent with the non-value-maximizing arguments.

T Mallikarjunappa and Panduranga Nayak (2013), has done the study with the objective to examine the stock price reaction for a period of 61 days surrounding the bid announcement day employing standard market model. BSE- 200 index is used as a proxy for the market. Results of the study showed that target company shareholders experienced substantial and statistically significant cumulative average abnormal returns (CAARs) of 27-37 percent — 37 percent when raw returns were employed and 27 percent when log returns were employed. Deepak K. Datta et al (1992) analyzed the empirical literature concerning the influence of various factors on shareholder wealth creation in mergers and acquisitions using a multivariate framework and a meta analysis approach. Their work indicate that while the target firm's shareholders gain significantly from mergers and acquisitions, those of the bidding firm do not. Target bonds have significantly larger returns when the target's rating is below the acquirer's, when the combination is anticipated to decrease target risk or leverage, and when the target's maturity is shorter than the acquirer's. (Mathew T. Billett et al (2004)).

## 4. Research Gaps and Conclusion

Most post-acquisition performance researches have only employed stock market event studies, which are of short-term nature and are not capturing the long term anticipated benefits from an acquisition due to information asymmetries. It is also observed that due to globalization importance of cross border M&A's in developed and developing economies have been increasing but there are very less number of researches related to wealth generation by shareholders of acquirers involved in cross border inbound and outbound acquisitions. Secondly there has been no attempt made till date to illustrate an integrated framework for long term approach of firm value creation using advanced measures like Economic Value added & Market Value added coupled with short term approach of Event Study Methodology. Third there are very few researches which focuses on whether shareholders of target and acquirer create more value in domestic M&A's or cross border M&A's? These gaps in existing literature require attention for the further research in the field of Mergers and Acquisitions.

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