3 International acquisitions and the globalization of firms from India

Andrew Delios, Ajai S. Gaur and Shawkat Kamal

Introduction

The internationalization process in India has undergone a considerable shift since the onset of the 1990s. Whereas previously India was a destination for the technologies and brands of foreign firms acquired primarily through licensing and technology transfer arrangements, since the mid-1990s, India's participation in the global economy has transitioned to one in which it has become a more important recipient of foreign direct investment (FDI) as analyzed by Chaisse, Chakraborty and Guha (this book, Chapter 10). It has become simultaneously a more active participant in investing in overseas markets (Mavlonov 2007; Pradhan 2008).

As part of the latter trend – outward FDI from India – firms domiciled in India have increasingly turned to international acquisitions as their modality of foreign direct investment. This trend is notable, particularly given its contrasts to the relative lack of propensity for firms based in Asian economies, such as Japan, South Korea and Taiwan, to use acquisitions as a mode of FDI, as compared to other modes, such as wholly owned greenfield investments or joint venture entries.

Aside from the relatively high propensity of Indian firms to engage in FDI via an international acquisition, India's position as the second largest emerging economy, behind China, makes it important to understand the international growth strategies of its firms. India's place in the global economy is increasingly being strengthened by its rapid growth in the first decade of the 2000s, as coupled to its large population base. Further, the strategies of firms from India are not burdened by a legacy of strong government participation in the management of these companies, again unlike in other large transition economies such as China, Taiwan and Russia, for example. (Ruet, this book, Chapter 4) Accordingly, the strategies of firms from India, as they seek positions in international markets, are likely to be motivated by growth and profitability considerations, that are similar, although not necessarily identical, to those of companies operating in mature markets, such as the United States and the developed economies of Western Europe.

Given the importance of understanding the phenomenon of the international acquisition strategy of firms from India, our approach is to explore the performance implications of their international expansions by acquisition. The methodology and conclusions for the analysis of the performance outcomes of international and domestic acquisitions is well-established in the finance and strategy literatures. A series of studies on international acquisitions has established a positive relationship between internationalization by acquisitions, and firm performance, as related to the internalization and extension of core competitive assets into international markets (Markides and Ittner 1994; Morck and Yeung 1991). Yet, this evidence, obtained primarily from an event study methodology, has not been a consistently repeated finding in the literature. A performance decline, in the form of negative gains in the stock market performance of a firm, tends to also emerge in many studies (e.g. Dewenter 1995; Eun *et al*. 1996, Moeller and Schlingemann 2005; Seth *et al*. 2000), illustrating the considerable strategy formulation and implementation challenges associated with an international acquisition. Consequently, although there is the potential to make competitive gains through the internalization and extension of a firm's proprietary assets to international markets, through an acquisition, these gains are often ephemeral.

A notable point of this aforementioned literature is that the evidence has been primarily derived from samples of the internationalization of firms from developed-country markets. Consequently, there is an empirical need to understand if the same trends or patterns will exist for the internationalization strategies of firms from developing countries and transition economy markets. A variety of features of developing and transition economies might lead to a net of antecedents that can lead to a different performance outcome for the acquisition strategy of firms from a developing-country market. These antecedents primarily relate to the institutional context in which the firm is situated. Although we will not go into detail in examining such institutionally related influences on the effectiveness of a firm's strategy, because of our focus on understanding the performance-related aspects of this phenomenon, we do note it here as a potential underlay for the relationships we observe. Our primary question to be addressed in this study is 'What are the performance-related implications of the internationalization by acquisition strategy of firms indigenous to India?'.

International acquisitions

'Acquisitions refer to the purchase of stock in an already existing company in an amount sufficient to confer control' (Kogut and Singh 1988: 412). Acquisitions allow a firm to acquire new technological resources (Prahalad and Hamel 1990). Acquisitions can also have a positive effect on organizational learning and can play a vital role in aiding a firm in escaping competency traps (Vermeulen and Barkema 2001). Acquisition of an existing firm can provides a parent firm with new managerial and financial resources (Caves and Mehra 1986). In their study of 75 major MNCs headquartered in the United States, Europe and Japan, Gupta and Govindarajan (2000) found that the subsidiaries that are acquired provide higher knowledge outflows to peer subsidiaries compared to those that are set up as greenfield operations. For a foreign entrant, an acquisition mode of entry creates the opportunity to acquire local brand names and to combine them with their firm-specific marketing skills (Hennart and Park 1993).

Table 3.1 The largest acquisition deals worldwide (2000–2006)

Rank	*Year*	*Acquirer*	*Target*	*Deal value (US$ millions)*
1	2000	*Merger*: America Online Inc. (AOL)	Time Warner	164,747
2	2000	Glaxo Wellcome Plc.	SmithKline Beecham Plc.	75,961
3	2004	Royal Dutch Petroleum Co.	Shell Transport & Trading Co.	74,559
4	2006	AT&T Inc.	BellSouth Corporation	72,671
5	2001	Comcast Corporation	AT&T Broadband & Internet Services	72,041

Table 3.2 The largest acquisition deals in the Asia-Pacific (2000–2006)

Rank	*Year*	*Acquirer*	*Target*	*Deal value (US$ millions)*
1	2005	*Merger*: Mitsubishi Tokyo Financial Group Inc.	UFJ Holdings Inc.	41,431
2	2000	Pacific Century CyberWorks Ltd	Cable & Wireless HKT	37,442
3	2000	Beijing Mobile, Shanghai Mobile, Tianjin Mobile Ltd, Hebei Mobile Ltd, Liaoning Mobile Ltd, Shandong Ltd, and Guangxi Mobile Ltd	China Mobile (Hong Kong) Ltd	34,008
4	2003	Deposit Insurance Corporation of Japan	Resona Bank Ltd	16,650
5	2000	Sanwa Bank Ltd	Tokai Bank Ltd	14,984

Acquisitions also allow a firm to quickly obtain market share and take advantage of the current opportunities (Andersson and Svensson 1994). This aspect of acquisitions can emerge as a consequence of the institutional environment of the market a firm is entering. Often legal barriers also require companies to consider acquisitions. For example, in many countries central governments can restrict the total number of mobile phone operators through the issuance of licenses. In such cases, a foreign company that is interested in entering the market only has the option to enter via acquisition.

These beneficial aspects of acquisitions have made an international acquisition strategy a common although not a necessarily dominant form of internationalization, particularly for firms from developed-country markets. As noted in Tables 3.1 and 3.2, acquisitions can also involve transactions that are very large in size.

Motivations acquisitions

Researchers have proposed several hypotheses to explain motivations behind acquisitions. These can generally be categorized under value-creating and non-value creating motivations. Value-creating motivations include the synergy hypothesis and the market power hypothesis. Non-value creating hypotheses include the managerial discretion hypothesis and the hubris hypothesis (Roll, 1986).

Value-creating motivations

Value-creating arguments claim that an acquisition takes place when the value of the combined firm is greater than the sum of the values of the individual firms (Bradley *et al*. 1988; Seth 1990a). Value creation, as defined by Seth (1990a), is realized by making the best use of a firm's assets and resources under environmental opportunities and constraints faced by the firm. In these instances, the combination of various resources of the acquirer and target firms in an acquisition provides the source of value creation.

Studies have shown that the additional values, or synergistic gain from acquisitions, are often derived from an increase in operational efficiency, or some form of financial gain (Seth 1990b; Singh and Montgomery 1987). Operating synergies refer to acquisitions that are undertaken with the goal of achieving economies of scale or scope by pooling various functions and resources of the merging firms. Such functions include production, R&D, marketing and management resources (Kitching 1967; Seth 1990a). Pooling of technological and marketing resources for example, could help the combined firm minimize redundant capacities, reduce costs, and in turn, enhance firm performance (Porter 1980; Seth 1990a).

The combined firm from an acquisition may also experience financial synergies in various forms. It may be able to attain scale economies when it raises money in capital markets due to its increased size (Wiggins 1981). When income streams of merging firms are imperfectly related, the variability and risk of cash flows are reduced. This may positively affect the firm's ability to borrow capital, again potentially improving firm performance.

According to the dominant-firm model, prices will rise as a consequence of an acquisition by a dominant firm (Seth 1990a). Firms can reduce the competition in a market through an acquisition and hence strengthen their ability to control prices, quantities, or the nature of products, generating abnormal profits as a result. In high-technology markets, acquisitions can provide small players with an opportunity to achieve a larger size so that they might be better able to share their operating and R&D costs and improve their competitive positions in the market. Empirical studies have provided evidence that market power serves as a source of value creation in mergers and acquisitions (Eckbo 1983; Stillman 1983).

Non-value increasing motivations

In addition to the idea that acquisitions can be a value-enhancing tool for a firm, researchers have also proposed another set of arguments stating that acquisitions might be driven by other factors that are unrelated to value enhancement. Among such arguments, the managerialism hypothesis and the hubris hypothesis are the most widely cited explanations.

The managerialism hypothesis suggests that managers will knowingly overpay in takeovers: managers embark on acquisitions to maximize their own utility at the expense of the shareholders of the acquiring firm (Jensen 1986; Morck *et al*. 1990). Individual managers might try to enhance their power, prestige, job-security and salaries by seeking corporate expansion or controlling a large empire (Baumol 1962). Since managerial compensation frequently is tied to the amount of assets under control, managers are more likely to seek higher rates of growth in assets than profits. Mueller (1969) suggested that acquiring firms' managers have discretionary control over decision making and attempt to maximize the growth of the firm subject to a profit constraint.

Mergers and acquisitions motivated by this managerial discretionary behavior have no synergistic gains to be allocated among the firms. Often termed empire building, managers tend to be willing to overpay for the target firms (Eun *et al*. 1996). This leads the managerialism hypothesis to predict that value is destroyed upon acquisition, since there is a transfer of value from the combined firm to the managers of the acquiring firm (Seth *et al*. 2002). Mathur *et al*. (1994) also pointed out three types of managers might probably demonstrate this managerial discretionary behavior: managers of firms with free or excess cash flows, manager of firms in declining industries, and managers of firms in slow-growth economies with limited investment opportunities.

The hubris hypothesis (Roll 1986) suggests that acquisitions occur because managers make mistakes in evaluating target firms, and the takeover premium merely reflects a random error. He further pointed out that each manager is likely to be over-confident in his or her ability to better manage the acquired assets than the average acquirer. Roll's (1986) extreme version of the hubris hypothesis predicts that there are no synergistic gains from takeover bids and the entire premium paid to the target firm is a transfer from the acquirer.

Seth *et al*. (2000) presented empirical evidence for a moderate version of the hubris hypothesis. If some corporate combinations do indeed result in synergistic gains, rational managers are motivated to undertake acquisitions seeking these gains. Although the expected synergistic gains are positive, because the valuation of the target may be erroneous, some such acquisitions may result in overpayment by the acquirer to the target, resulting in a loss to shareholders of the acquiring firm.

Motives and the empirical evidence

Studies have found evidence that suggest the presence of multiple motives such as synergy, managerialism and hubris in acquisition transactions both in domestic and international acquisitions (Berkovitch and Narayanan 1993; Seth *et al*. 2000). Seth *et al*. (2002) suggested that a possible reason to explain why previous studies have not found strong empirical evidence regarding the sources of value creation in international acquisitions is that they do not take into account that different motives may exist for undertaking these acquisitions. In effect, early studies tended to test the joint hypothesis that the acquisitions in their sample are characterized by synergy, and that some underlying source of this synergy is relevant for explaining value creation.

Empirical studies on the performance of acquisitions generally use one of two major approaches: event studies and outcome studies. The results from various event studies suggest that overall, acquisitions create value for shareholders of the target and acquirer as a whole; however, most of the gains accrue to the target firm's shareholders (Jarrell *et al*. 1988; Jensen and Ruback 1983). Most studies find evidence that within a time window of several weeks prior to and after the announcement of the acquisition, the target's stock price rises sharply, such that shareholders of the target firm earn substantial positive abnormal returns (Asquith 1983; Bradley 1980; Bradley *et al*. 1983; Dodd and Ruback 1977; Eckbo 1983). Less consistent however, are the results for acquiring firms.

Using a time period of 20 days before the announcement as the event window, Asquith *et al*. (1983) examined 214 merger bids initiated by Fortune 1000 firms during the period from 1963 to 1979. Their study shows that the acquiring firms experienced an average cumulative abnormal return (CAR) of 2.8 percent. Bradley *et al*. (1988) also finds evidence that acquiring firms in the United States earned positive returns during the unregulated period of 1963–1968. Contrary to the findings mentioned above, many other studies present opposite results. These studies provide considerable evidence that acquiring firms' shareholders experience zero or negative gains. Asquith (1983), and Asquith *et al*. (1983) find that acquiring firms' shareholders tend to experience either zero or small negative returns; Bradley *et al*. (1988) showed that bidders obtained negative but insignificant returns.

Several other studies have extended the time horizon examined beyond the usual announcement-period event windows (Loughran and Vijh 1997; Mitchell and Stafford, 2000; Rau and Vermaelen 1998). The long-horizon event studies suggest a negative drift in the stock prices of acquiring firms. Using a sample of 204 acquisitions undertaken during the period 1977–1996, Megginson *et al*. (2004) found that acquirers suffered abnormal returns of negative 13 percent within the three-year period that an acquisition transaction had taken place. Loughran and Vijh (1997) find the abnormal returns over the five-year period after the acquisition announcements are a negative 24 percent for acquirers where the acquisition is financed by a stock transaction.

Empirical research on international acquisitions

Empirical research on international acquisitions can be broadly categorized into three main streams. The first stream explores broad topics of international acquisitions, including the integration between the acquirer and target. The second stream examines post acquisition performance using relatively longer term measures in comparison with other modes of entry. Finally, researchers examine the issue of wealth creation to shareholders by international acquisitions. This stream is common to finance literature and is usually conducted by observing stock market reactions to acquisition announcements.

Firms are able to gain positive returns from an international acquisition based on the assumption that firms enter foreign markets to exploit their specific resources to take advantage of imperfections in the markets (Buckley and Carsson 1976; Morck and Yeung 1992). Studies show that wealth is created for both acquirer and target firm shareholders and that this wealth creation accrues from the integrating benefits of internalization, synergy, and risk diversification (Kang 1993; Markides and Ittner 1994; Morck and Yeung 1991, 1992).

Unlike domestic acquisitions which are often reported to reduce the acquirer's shareholder value while only improving the target's shareholder value (Kaplan and Weisbach 1992), market reactions to international acquisitions show significant differences. Several studies on US acquirers purchasing non-US firms find evidence of wealth creation for the acquiring firms' shareholders (Markides and Ittner 1994; Morck and Yeung, 1992). Studies also find wealth creation effects for non-US acquirers purchasing US firms (Kang, 1993), providing further evidence that international acquisitions provide positive returns for acquirer firm shareholders.

Morck and Yeung (1992) found that the acquirers' R&D intensity, advertising intensity and management quality were positively associated with acquirer's abnormal returns. These firms had information-based resources that allowed them to more effectively internalize the assets of the target firm (Shimizu *et al*. 2004). Markides and Ittner (1994) used a similar sample of 276 international acquisitions by US firms between 1975 and 1988. They found several other factors that were positively related to acquiring firms' abnormal returns. These factors specifically are the acquirer's home currency strength, industry advertising intensity, industry concentration, prior international experience, business relatedness, and acquirer relative size compared with the target firm.

Harris and Ravenscraft (1991), examined non-US acquiring firms and US target firms and found that US targets of foreign buyers had significantly larger wealth gains than those purchased by US firms. Kang (1993) examined 119 Japanese firms that bid on 102 US firms from 1975 to 1988. His findings supported those of studies mentioned earlier, and that Japanese acquisitions of US firms created wealth for both target and acquirer firms. He also found that returns to Japanese acquirers were positively related to the acquirers' total debt and borrowings from financial institutions as well as the appreciation of the yen against the dollar. The debt level in this case was used as a proxy for agency costs, in that a high debt level often reduces potential agency costs (Jensen 1986).

There is, however, some research which finds conflicting evidence regarding wealth creation in international acquisitions, compared to the studies mentioned above. Examining 112 international acquisitions by US firms from 1978 to 1990, Datta and Puia (1995), reported opposite results from those mentioned above. They found that acquisitions, on average, do not create value for acquiring firm stakeholders. This could possibly be due to the inclusion of newer acquisitions compared to earlier studies, and to the fact that the impact of globalization has reduced the differences between domestic and international acquisitions (Shimizu *et al*. 2004). They also found that the cultural distance between target and acquirer firms was inversely related to wealth gains for acquiring firm shareholders.

Several studies find evidence that the tax system of the country in which the acquisition deal is consummated is highly influential. Cebenoyan *et al*. (1992) and Manzon *et al*. (1994) found that US acquirers benefit from wealth gains when their targets are located in high-tax countries, while they tend to earn lower returns when their targets are in low-tax countries. However, there is contradicting evidence regarding the influence of the tax systems as well. Cakici *et al*. (1996), in studying wealth creation in foreign acquirers, found that tax effects, exchange rate effects, as well as R&D intensity, were not relevant, and that wealth effects were most influenced by country factors.

International acquisitions in Asia

Cross-border acquisitions in Asia can be classified into three types: firms of developed countries (especially the United States and Western and Europe) acquiring Asian targets, intra-regional international acquisitions, and outbound acquisitions. Acquisitions into Asia account for the majority of cross-border acquisition activity that takes place, but the last decade has seen outbound and intra-Asian acquisition activity increase significantly. The value of international acquisitions by Asian acquirers was US$25 billion in 2001 compare to just US$2.5 billion a decade earlier. (UNCTAD 2003: 291)

Even though the number of acquisition transactions in Asia continues to grow, limited research has been conducted in this area. Kale (2004), studied acquisitions in India using a sample of 698 acquisitions during the period 1992–2002. He found that acquisitions in India created positive value for acquired and acquiring companies over the entire study period. The value creation was significantly greater for acquired companies (8.79 percent) compared to the acquiring companies (1.71 percent). In addition, he found that multinational acquirers, on average, created significantly greater value in their transactions than local acquirers did; but this difference in value creation reduced significantly over time. He concluded that the greater value creation of multinational acquirers might be seen as a reflection of their greater acquisition experience and superior acquisition skills.

Chari *et al*. (2004), studied a sample of 1629 observations of international acquisitions by firms from developed markets that purchased publicly traded emerging market target firms from Asia and Latin America between 1988 and 2002. They find evidence that both target and acquirer firms experience positive returns, with the value created accruing more to the target firms' shareholders. They further note that the benefits of the acquisitions seem to stem from the transfer of majority control from the emerging market targets to developed market acquirers.

Pangarkar and Lie (2004) using a sample of 115 acquisitions by Singapore acquirers find robust support for the idea that acquirers experience significantly positive returns. In contrast, Koh and Lee (1988) find zero returns to acquiring firms based on their study of a sample of 85 acquisitions by Singaporean acquirers of Singaporean targets during the period from 1973 to 1984. Using a smaller sample of 23 Singapore acquirers, Ding *et al*. (1996) concluded that acquirers experience insignificant returns. In the next section, we extend this line of research on the performance effects of acquiring firms based in Asia, using a sample of firms based in India.

Sample and methods

We develop our sample of firms using the acquisition experience of firms based in India.

The internationalization of firms from India is part of a larger trend of the internationalization of firms from other developing-country markets. Firms situated in emerging economies have been steadily increasing their contribution in the outward FDI flows. This flow increased from a mere US$65 billion in 1980 to US$849 billion, which was 12 percent of the world's FDI outflows in 2002 (Wright *et al*. 2005), to even more substantive levels of FDI by the late 2000s.

Even though the growth has been strongest most recently, incidents of investing abroad by firms from developing nations is not a recent event. Lecraw (1977) was among the earliest to examine this phenomenon and he found that market protection and development in the host country, avoidance of quotas in high-income countries, and risk reduction through diversification, were among the main motives for undertaking foreign direct investment. Investments tended to be in the direction of neighboring less-developed countries (Lecraw 1993).

In the 2000s, there has been a marked shift in the destination for FDIs of firms from developing nations. In addition to investing in less-developed countries and newly industrialized economies, firms from emerging economies are also investing in developed economies. In their study of 328 Taiwanese firms, Makino *et al*. (2002) found that firms from newly industrialized economies tended to invest in developed countries when they had a strategic asset-seeking and market-seeking motivation. Emerging market multinational enterprises often engage in aggressive acquisitions of strategic resources to overcome their latecomer disadvantage on the global stage (Luo and Tung 2007). Firms from India are part of this race to invest abroad.

Sample

We derived our sample from the population of all the acquisitions made by Indian firms during the 1986–2006 time period. We collected information on acquisitions made prior to 1998 from the reports put forth by the India Investment Centre. The India Investment Centre provided a comprehensive list of foreign acquisitions made by Indian firms until 1998, after which it stopped publishing these reports. For later years, we relied on the information provided in the Thomson Financial Database. We focused only on the acquisitions in which an Indian firm acquired a majority stake. Further, we removed the acquisitions which were made by firms that were not publicly traded on the Bombay Stock Exchange. These procedures gave us a list of 330 acquisitions. Since we could not obtain reliable share-market data for the years prior to 2002, we limited our calculations of the cumulative abnormal return (CAR) to the parent firm to the acquisition events that happened post-2002. This resulted in a sample of 224 acquisition events for the final analysis.

The 224 acquisition events included in our analysis involved 127 different acquiring companies. The targets in our sample were from 44 different countries with the maximum number coming from the USA (30.36 percent) and the United Kingdom (16.07 percent). The acquiring companies were from 33 different industries. The acquisition activities were dominated by firms operating in the business services (25.45 percent), pharmaceuticals (12.95 percent) and prepackaged software industry (10.27 percent). The targets were from 31 different industries with more than half of them operating in business services (22.32 percent), pharmaceuticals (15.18 percent) and prepackaged software (13.39 percent). A large majority (70.54 percent) of the acquisitions took place between firms operating in related industries, based on the two digit SIC code of the acquirer and target.

Methodology

We used the standard techniques of event study analysis and regression analysis to estimate the impact of an acquisition on shareholder wealth for the acquiring firms during the immediate period, before and after, of an acquisition announcement. This technique allowed us to determine whether there was an abnormal stock-price effect associated with the acquisition announcement. The abnormal return on the share price reflected the difference between the return associated with the acquisition announcement and the firm's expected return based on the past performance of its shares in the market. The announcement day of the acquisition was treated as the '0' day for the event. We used a short event window as we wanted to reduce any dilution in the effect on shareholder wealth due to events outside that of the acquisition itself. Hence, the maximum event window was kept to a period of 15 days.

As capital markets in emerging economies such as India might not be very efficient, there was a possibility of finding inconsistencies in the outcome of the analysis for different time windows. Accordingly, we needed to check the consistency of the outcomes. Thus, we calculated the CAR using four different time windows ranging from $t = -1$ (one day before the announcement), 0 to $t = -7$ (seven days before the announcement), $t = +7$ (seven days after the announcement). The share price of the acquiring companies and the market index used were collected initially for the $t = -7$ to $t = +7$ period to cover all four time windows. For analytical purposes, $t = -1$ year to $t = +$ 30 days was used as the period for collecting data for the share price of the acquiring companies and the market index. We decided to use a side benchmark index and we thus used the BSE-500 index. The BSE-500 index, inaugurated on 9 August 1999, represents nearly 93 percent of the total market capitalization on the Bombay Stock Exchange. It includes stocks from all 20 major industries of the Indian economy.

We used a market model to represent the return-generating process,

$$R_{it} = \alpha_i + \beta_i \mathrm{R}_{mt}$$

where,

R_{it} = daily return for firm i over day t
R_{mt} = the return on the market portfolio over day t

We used a simple linear regression to estimate the model parameters. After obtaining the value of the parameters (equation and equation) from the regression, we calculated the daily abnormal returns for the four different time windows for each acquisition transaction. The formula used was as follows (this is an example of an event window of 15 days);

$$AR_{it} = R_{it} - \hat{\alpha}_i - \hat{\beta}_i \; R_{mt,}(t = -7 \;\; to \;\; t = +7)$$

Finally we obtained the cumulative abnormal returns for each firm by aggregating the daily abnormal returns over the different event periods (the following formula shows the example of a 15 day event window):

$$CAR_i = \sum_{t=-7}^{t=+7} AR_{it}$$

Results

We begin our depiction of the results by describing essential trends in acquisitions by Indian firms. As indicated in Figure 3.1, there has been a significant increase in the number of cross-border acquisitions by Indian firms since the year 2000. Of all the international acquisitions undertaken by the Indian firms after 1985, more than 80 percent were undertaken on or after the year 2000. This phenomenon might have its roots in the economic liberalization policy of the Indian Government during the early 1990s, although the effect was not immediate. Despite some negative speculation at the outset, this economic liberalization program ultimately benefited domestic companies as they became more competitive and started operating with a broader geographic horizon. Also, the economy as a whole has done very well since, with high GDP growth rates for India since the early 1990s.

There was a notable decrease in the number of international acquisitions by Indian firms immediately after 2001. One reason for this change in direction might be the effect of the 11 September 2001 events on the global economy. However, this downturn was soon reversed, with continued growth to 2008. It has to be noted though that this outward investment was concentrated in a few sectors only. The three leading sectors for international acquisition accounted for almost 50 percent of the total acquisitions by Indian firms after 2001. The Indian companies have made their mark in the world with their expertise in providing business services and software development. Thus it was no surprise that these two were amongst the leading sectors where acquisitions took place. The pharmaceuticals sector also saw a substantial number of international acquisitions taking place, thanks largely to the numerous acquisitions by companies such as Ranbaxy Laboratories.

Our analysis of the cumulative abnormal returns (CARs) suggested that the shareholders of acquiring companies from India gained from the international acquisitions that took place (Table 3.3). For all the different time windows we studied, we found positive average CARs for the shareholders of the acquiring

Figure 3.1 International acquisitions by Indian firms

Table 3.3 Effect of acquisitions on the market value of acquiring companies

Returns	*Average change in value*	*Gainers*	*Losers*
CAR (−1, 0)	2.24%	143	81
CAR (−1, +1)	2.80%	154	70
CAR (−3, +3)	2.64%	131	93
CAR (−7, +7)	2.53%	121	103

companies. The average CARs were more or less consistent for all time periods considered, hovering between 2 and 3 percent. In addition, it was found that more companies were gainers rather than losers as far as the CAR for their stocks were concerned. This was true in all the different time windows considered for the analysis. However, the gainer to loser ratio was not consistent and varied widely ranging from 1.17 to 2.20. All these pieces of evidence suggest that, in general, Indian firms are creating shareholder wealth through international acquisitions. The fact that we found the results to be consistent over different time windows enhances the level of confidence we place in this finding.

As one sensitivity test for these results, we also looked at the difference in the average change of value between acquisitions made in the developed and the developing nations (Table 3.4). We found that for all the time windows, acquisitions made in developed countries resulted in seemingly greater level of returns for the acquiring company's shareholders than acquisitions made in the developing countries. However, a two-tailed *t*-test indicated that the difference in the mean CAR between acquisitions made in developed and developing countries was only significant (at a 90 percent confidence interval) in the case of CAR

Table 3.4 Performance of acquiring firms grouped by region of target

Returns	*Average change in value*	
	Developed country	*Developing country*
CAR (–1,0)	2.56%	1.16%
CAR (–1,+1)	3.14%	1.64%
CAR (–3,+3)	3.07%	1.19%
CAR (–7,+7)	2.85%	1.45%
Number	173	51

Table 3.5 Performance of acquiring firms grouped by industry of target

Returns	*Average change in value*		
	Service	*Manufacturing*	*Extracting*
CAR (–1,0)	3.01%	1.66%	1.22%
CAR (–1,+1)	3.42%	2.37%	1.41%
CAR (–3,+3)	3.31%	2.06%	2.90%
CAR (–7,+7)	2.43%	2.67%	1.78%
Number	99	117	8

(–1, 0) and CAR (–1, +1) only. Hence, we are reluctant to draw firm conclusions about a country of destination effect in terms of generation of positive CARs for Indian acquirers.

Next, we looked at the differences in the change of the average CAR values between three acquisitions made in three broad industry categories – manufacturing, services, and extractive industries. The results showed that acquisitions made in the services and manufacturing industries had higher positive CAR values compared to that of extractive industries. Between the two of them, acquisitions made in the service industry performed better than those made in the manufacturing industry. Our *t*-tests indicated that the difference in the mean CAR was significant (at a 95 percent confidence interval) only between service and manufacturing sectors and only in the case of CAR (–1, 0). The other cases were not significant, even at the 90 percent confidence interval level. The insignificance in the *t*-test result for the differences between the average CAR values of the extractive industry firms and firms in the other two industries is most likely caused by the fact that the sample had only eight observations from the extractive industry firms (which was less than 4 percent of the total number of acquisitions in the sample).

Finally, we performed tests to analyze differences in average CAR values between firms that entered the same industry by an acquisition, entered a related industry by acquisition and entered a new industry by acquisition. These tests yielded mixed results. Although the firms that entered related or new industries seemed to do better than firms that entered the same industry, the overall finding was

Table 3.6 Performance of acquiring firms grouped by industry relatedness of acquirer and target

Returns	*Average change in value*		
	Same industry	*Related industry*	*New industry*
CAR (−1,0)	1.96%	3.10%	2.09%
CAR (−1,+1)	2.45%	3.10%	3.51%
CAR (−3,+3)	2.34%	3.27%	2.82%
CAR (−7,+7)	131	50	43

not conclusive, as different time periods showed different outcomes. Our *t*-tests also indicated that differences in mean CAR values were not significant (at 90 percent confidence interval) for all possible mean comparisons between these categories.

Conclusion

International acquisitions by firms based in India have grown strongly through much of the first decade of the 2000s. The strong growth is a marker of the expansion of the Indian economy both in terms of GDP growth and in terms of growth into international markets. The growth of international acquisition activity coupled alongside the persistent question of whether and how gains are obtained for acquiring firms motivated our investigation in the performance outcomes of acquirers based in India.

Our study focused on the analysis of 224 acquisition transactions. We utilized a standard methodology to explore whether value was created in the acquisitions for the acquiring firm. Our event study analysis revealed that Indian acquirers obtained a positive return, with their average cumulative abnormal return ranging from 2.2 percent to 2.8 percent, depending on the length of window over which a firm's stock price movements were observed. Among the transacting firms, approximately two-thirds of firms achieved a positive return, while the other third had a negative market response on the news of the international acquisition.

This evidence tends to stand at odds with much of the event study performance analysis of international acquisitions. Although key studies have pointed to a potential positive performance impact of international acquisition announcements, through the effective internalization of a firm's proprietary assets when moving into overseas markets (Markides and Ittner 1994; Morck and Yeung 1991, 1992), empirical evidence rarely supports this point unambiguously. Indeed, much of the evidence points to a negative impact of an international acquisition announcement on the acquiring firm's market performance. This general trend aligns well with the similar empirical observation made for domestic acquisition announcements and the market performance of acquiring firms.

The positive performance impact of an acquisition announcement for acquiring firms based in India suggests that the market recognizes that the strategy of these firms is creating value through several possible mechanisms. Although it was not the focus of our study to investigate the antecedents to the performance outcomes of acquisitions announcements, there are several possible means by which a competition-enhancing outcome can be created in an international acquisition.

One prominent means of creating value is through the effective internalization and extension of the proprietary assets of the acquiring or target firms involved in the acquisition. A second means is a reconfiguration of the resources of the acquiring and target firms to reduce costs through the elimination of redundancies, or to create value through a more effective alignment of the potentially complementary competencies of the acquiring and target firm. A third means is again a reconfiguration of resources, but this time oriented towards a shift to structuring the acquired and target firms resources on a global level, instead of on a multi-local level. A fourth, but more long-term outcome, is an organizational learning influence that results in the development of new competencies for competition in new markets. Clearly there is much potential in the empirical trends we observed to extend this research to identify the determinants of value-creating in the international acquisitions of firms from India.

Although it was not our objective to make this form of analysis and inference in our study, we did investigate several key characteristics of these acquisitions to identify whether one feature or another was driving this result in part or in full. We grouped acquisitions into the country of origin of the target, as well as industry of origin and finally by whether the target operated in the same, related or unrelated industry as compared to the acquirer. Across these analyses, there was no clear category in which positive returns were more prominent, and accordingly, we could draw no firm conclusions from these analyses.

The study was conducted on data obtained from companies listed in one stock exchange only. In addition, we could only conduct the study over a rather short period of time as sufficient data were not available. Future researches may take necessary steps to avoid these limitations and conduct a more comprehensive study. Although the gainers were more than the losers in our sample, some firms did fail to create positive value for the shareholders. Future researches may also focus on this aspect and try to find out why some firms can create positive value for their shareholders while others fail to do so.

Our study hence provides initial evidence on the notably positive performance outcomes of the international acquisitions of acquiring firms based in India. We found that acquiring firms experienced a positive market reaction ranging from 2.2 percent to 2.8 percent, on average. This phenomenon of international acquisitions by these firms is but part of the larger phenomenon of the increasing globalization of the economy in India, in which outward foreign direct investment is playing an increasingly prominent role. It is also part of the larger phenomenon of the substantial growth in outward foreign direct investment by firms from emerging markets, in which acquisitions are also an important component. In a related fashion, the challenge remains for research to establish the basic trends in these prominent phenomena as a means by which we can deepen our understanding of the characteristics of these events, and provide good empirical grounding for future research into the causal nature of these events.

References

Andersson, T. and Svensson, R. (1994) Entry modes for direct investment determined by the composition of firm-specific skills, *Scandinavia Journal of Economics,* 96 (4): 551–560.

Asquith, P. (1983) Merger bids, uncertainty, and stockholder returns, *Journal of Financial Economics*, 11: 51–83.

Asquith, P., Brunner, R.F. and Mullings, D.W. (1983) The gains to bidding firms from mergers, *Journal of Financial Economics*, 11: 121–139.

Baumol, W.J. (1962) On the theory of the expansion of the firm, *American Economic Review*, 52 (5): 1078–1087.

Berkovitch, E. and Narayanan, M.P. (1993) Motives for takeovers: An empirical investigation, *Journal of Financial and Quantitative Analysis*, 28: 347–362.

Bradley, M. (1980) Interfirm tender offers and the market for corporate control, *Journal of Business*, 53: 345–376.

Bradley, M., Desai, A. and Kim, E.H. (1983) The rationale behind interfirm tender offers: Information or synergy?, *Journal of Financial Economics*, 11: 183–206.

Bradley, M., Desai, Anand and Kim, E. Han (1988) Synergistic gains from corporate acquisitions and their division between the stockholders of target and acquiring firms, *Journal of Financial Economics*, 21: 3–40.

Buckley, P. and Casson, M. (1976) *The Future of the Multinational Enterprise.* London: Macmillan.

Cakici, N., Hessel, C. and Tandon, K. (1996) Foreign acquisitions in the United States: Effect on shareholder wealth of foreign acquiring firms, *Journal of Banking and Finance,* 20 (2): 307–329.

Caves, R.E. and Mehra, S. (1986) Entry of foreign multinationals into US manufacturing industries, in M. Porter (ed.) *Competition in Global Industries*. Boston, MA: Harvard Business School Press, 459–481.

Cebenoyan, A.S., Papaioannou, G. and Travlos, N.G. (1992) Foreign takeover activity in the US and wealth effect for target firm shareholders, *Financial Management,* 21 (3): 58–68.

Chari, A., Ouimet, P., and Tesar, L. (2004) 'Cross border mergers and acquisitions in emerging markets: The stock market valuation of corporate control,' Working Paper, University of Michigan Business School, Ann Arbor, MI.

Datta, D.K. and Puia, G. (1995) Cross-border acquisitions: An examination of the influence of relatedness and cultural fit on shareholder value creation in US acquiring firms, *Management International Review*, 35 (4): 337–359.

Dewenter, K.L. (1995) Does the market react differently to domestic and foreign takeover announcements? Evidence from the us chemical and retail industries, *Journal of Financial Economics*, 37 (4): 421–441.

Ding, D.Y.K., Ang, J., Khoo, B.G. and Toh, S.F. (1996) Is shareholders' wealth affected by acquisition announcements?, *SES Journal,* October: 32–36, 74.

Dodd, P. and Ruback, R. (1977) Tender offers and stockholder return: An empirical analysis, *Journal of Financial Economics*, 5: 351–374.

Eckbo, B.E. (1983) Horizontal mergers, collusion and stockholder wealth, *Journal of Financial Economics,* 11 (April) 241–273.

Eun, C.S., Kolodny, R. and Scheraga, C. (1996) Cross-border acquisitions and shareholder wealth: Tests of the synergy and internalization hypotheses, *Journal of Banking and Finance*, 20 (9): 1559–1582.

Gupta, Anil K. and Govindarajan, Vijay (2000) Knowledge flows within multinational corporations, *Strategic Management Journal* 21 (4): 473–496.

Harris, R.S. and Ravenscraft, D. (1991) The role of acquisitions in foreign direct investment: evidence from the U.S. stock market, *Journal of Finance,* 46: 825–844.

Hennart, J. and Park, Y. (1993) Greenfield vs acquisitions: The strategy of the Japanese investors in the United States, *Management Science*, 39 (9): 1054–1070.

Jarrell, G.A., Brickley, J.A. and Netter, J.M. (1988) The market for corporate control: The empirical evidence since 1980, *Journal of Economic Perspectives*, 2: 49–68.

Jensen, M.C. (1986) Agency costs of free cash flow: Corporate finance and takeovers, *American Economic Review*, 76 (May): 323–329.

Jensen, M. Ruback, R. (1983) The market for corporate control: The scientific evidence, *Journal of Financial Economics*, 1: 5–50.

Kale, P. (2004) 'Acquisition value creation in emerging markets: An empirical study of acquisitions in India', *Academy of Management Best Paper* Proceedings, New Orleans, LA.

Kang, J.K. (1993) The international market for corporate control: Mergers and acquisitions of US firms by Japanese firms, *Journal of Financial Economics*, 34: 345–371.

Kaplan, S.N. and Weisbach, M.S. (1992) The success of acquisitions: evidence from divestitures, *Journal of Finance,* 47: 107–138.

Kitching, J. (1967) Why do mergers miscarry? *Harvard Business Review*, 45 (6): 84–102.

Kogut, Bruce and Singh, Harbir (1988) The effect of national culture on the choice of entry mode, *Journal of International Business Studies*, 19 (3): 411–432.

Koh, F. and Lee, S.H. (1988) Risks and returns of acquiring and acquired firms in Singapore, *Asia Pacific Journal of Management*, 5 (3): 157–168.

Lecraw, Donald J. (1977) Direct investment by firms from less developed countries, *Oxford Economic Papers*, 29 (3): 442–457.

Lecraw, Donald J. (1993) Outward direct investment by Indonesian firms: Motivation and effects, *Journal of International Business Studies*, 589–600.

Loughran, T. and Vijh, A.M. (1997) Do long-term shareholders benefit from corporate acquisitions?, *Journal of Finance,* 52 (December): 1765–1790.

Luo, Y. and Tung, Rosalie L. (2007) International expansion of emerging market enterprises: A springboard perspective, *Journal of International Business Studies*, 38 (4): 481–498.

Makino, S., Lau, C. and Yeh, R. (2002) Asset-exploitation versus asset-seeking: Implication for location choice of foreign direct investment from newly industrialized economies, *Journal of International Business Studies*, 33 (3): 403–421.

Manzon, G.B., Sharp, D.J. and Travlos, N.G. (1994) An empirical study of the consequences of US tax rules for international acquisitions by US firms, *Journal of Finance,* 49: 1893–1904.

Markides, C.C. and Ittner, C.D. (1994) Shareholder benefits from corporate international diversification: Evidence from US international acquisitions, *Journal of International Business Studies*, 25 (2): 343–366.

Mathur, I., Rangan, N., Chhachhi, I. and Sundaram, S. (1994) International acquisitions in the United States: Evidence from returns to foreign bidders, *Managerial and Decision Economics,* 15 (2): 107.

Mavlonov, Ibrokhim R. (2007) Achievements of India's foreign investment policy, *Finance India*, 21 (4): 1337–1354.

Megginson, W. Morgan, A. and Nail, L. (2004) The determinants of positive long-term performance in strategic mergers: Corporate focus and cash, *Journal of Banking & Finance*, 28 (3): 523.

Mitchell, M.L. and Stafford, E. (2000) Managerial decisions and long term stock price performance, *Journal of Business*, 73: 287–329.

Moeller, S.B. and Schlingemann, F.P. (2005) Global diversification and bidder gains: A comparison between cross-border and domestic acquisitions, *Journal of Banking and Finance*, 29: 533–564.

Morck, R., Shleifer, A. and Vishny, R.W. (1990) Do managerial objectives drive bad acquisitions? *Journal of Finance,* 45, (March): 31–48.

Morck, R. and Yeung, B. (1991) Why investors value multinationality, *Journal of Business*, 64 (2): 165–187.

Morck, R. and Yeung, B. (1992) Internalization: An event study test, *Journal of International Economics*, 33: 41–56.

Mueller, D.C. (1969) A theory of conglomerate mergers, *Quarterly Journal of Economics*, 83 (4): 643–659.

Pangarkar, N. and Lie, Junius, R. (2004) The impact of market cycle on the performance of Singapore acquirers, *Strategic Management Journal,* 25, (12): 1209–1317.

Porter, M. (1980) *Corporate Strategy*. New York: Free Press.

Pradhan, Jaya Prakash (2008) The evolution of Indian foreign direct investment: Changing trends and patterns, *International Journal of Technology and Globalization*, 4 (1): 5–5.

Prahalad, C.K. and Hamel, G. (1990) The core competence of the corporation, *Harvard Business Review*, 68 (3): 79–91.

Rau, P.R. and Vermaelen, T. (1998) Glamor, value and the post-acquisition performance of acquiring firm, *Journal of Financial Economics*, 49 (2): 223–253.

Roll, R. (1986) The hubris hypothesis of corporate takeovers, *Journal of Business,* 59 (2): 197–216.

Seth, A. (1990a) Value creation in acquisitions: A re-examination of performance issues, *Strategic Management Journal*, 11: 99–115.

Seth, A. (1990b) Sources of value creation in acquisitions: An empirical investigation, *Strategic Management Journal,* 11: 431–446.

Seth, A., Song, K.P. and Pettit, R. (2000) Synergy, managerialism or hubris? An empirical examination of motives for foreign acquisitions of us firms, *Journal of International Business Studies*, 31 (3): 387–405.

Seth, A., Song, K.P. and Pettit, R.R. (2002) Value creation and destruction in cross-border acquisitions: An empirical analysis of foreign acquisitions of US firms, *Strategic Management Journal*, 23 (10): 921–940.

Shimizu, K., Hitt, M., Vaidyanath, D. and Pisano, V. (2004) Theoretical foundations of cross-border mergers and acquisitions: A review of current research and recommendations for the future, *Journal of International Management,* 10: 307–353.

Singh, H. and Montgomery, Cynthia A. (1987) Corporate acquisition strategy and economic performance, *Strategic Management Journal*, 8 (4): 377–386.

Stillman, R. (1983) Examining antitrust policy towards horizontal mergers, *Journal of Financial Economics,* 11 (April): 225–240.

UNCTAD (2003) world Investment Report 2003: FDI Policies for Development: National and international perspectives. New York and Geneva: United Nations, 294.

Vermeulen, F. and Barkema, Harry (2001) Learning through acquisitions, *Academy of Management Journal*, 44: 457–476.

Wiggins, S.N. (1981) A theoretical analysis of conglomerate mergers, in R.D. Blair and R. Lanzilotti (eds), *The Conglomerate Corporation*. Cambridge, MA: Oelgeschlager, Gunn & Hain, 53–70.

Wright, M., Filatotchev, Igor Hoskisson, Robert E. and Peng, Mike W. (2005) Strategy research in emerging economies: Challenging the conventional wisdom, *Journal of Management Studies*, 42 (1): 1–33.