INDIAN INSTITUTE OF MANAGEMENT CALCUTTA

MERGERS & ACQUISITIONS IN INDIA, THE LONG-TERM POST-MERGER PERFORMANCE OF FIRMS AND THE STRATEGIC FACTORS LEADING TO M&A SUCCESS

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by

K. RAMAKRISHNAN

Submitted by :

K. Ramakrishnan

Forwarded by:

Sushil Khanna
(Thesis Supervisor)

Accepted by:

Sudip Chaudhuri
(Chairperson, Fellow Programme)

ABSTRACT

Even though mergers and acquisitions (M&A) have been an important element of corporate strategy all over the globe for several decades, research on M&As has not been able to provide conclusive evidence on whether they enhance efficiency or destroy wealth. There is thus an ongoing global debate on the effects of M&As on firms.

Mergers and acquisitions have become common in India today. However, very little appears to be known about the long-term post-merger performance of firms in India, and the strategic factors that affect this performance. Our study attempts to fill this gap in knowledge about M&As in India.

We have carried out statistical analyses of financial data pertaining to 87 pairs of merged firms. These mergers took place in the period 1996 to 2002. Out of these 87 mergers, 64 are between firms belonging to related industries and 23 to unrelated industries. Stock is the predominant method of payment for the acquired firm (in 76 out of 87 mergers), and transfer of corporate control has taken place in 37 of the 87 mergers. Fourteen of the acquired companies were sick and had been referred to the Board for Industrial and Financial Reconstruction (BIFR) at the time of their merger.

The performance of mergers has been gauged in two ways in this study – by determining whether the long-term post-merger financial performance has changed significantly, and by assessing the wealth gains to shareholders of the acquiring, acquired and the combined firms on the announcement of mergers.

We have measured financial performance of the merging firms as their pretax operating cash flow scaled by their operating assets. It is found that the merged firms demonstrate a significant improvement of 2.8% in long-term financial performance post-merger, compared to their pre-merger performance.

As far as wealth gains on merger announcement are concerned, only the shareholders of the acquired firms appear to be enjoying significant positive share price returns of 11.6%. The shareholders of the acquiring firms and the combined firms do not seem to be witnessing any significant change in returns.

With regard to the strategic factors affecting long-term post-merger financial performance, related mergers seem to be performing 5.4% lower than unrelated mergers. Both the transfer of corporate control from the acquired firm to the acquiring firm, and the business health of the acquired firm are positively related to the long-term post-merger performance of the firms. The relative size of the acquired firm and the method of payment for the acquired firm do not appear to be playing a role in affecting post-merger performance.

In the case of the effect of the strategic factors on the wealth gains on merger announcement, we find that the mergers in which there is no transfer of corporate control seem to be conferring significant positive share price returns of 21.1% on the shareholders of the acquired firms. This is not the case for the shareholders of the acquiring firms and the combined firms. In the case of mergers where there is a transfer of management control, none of these three groups of shareholders witnesses any abnormal returns on announcement of the merger.

The wealth gains to acquired firm shareholders on announcement of a merger are positively influenced by the relative size and the pre-merger performance of the acquired firm. The transfer of corporate control from the acquired firm to the acquiring firm is negatively associated with these abnormal share price returns. The level of industry-relatedness of the acquired and the acquiring firms, the method of payment for the acquired firm and the business health of the acquired firm do not appear to be playing a role in affecting the share price returns to the acquired firm shareholders, on announcement of a merger.