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Theory and Practice of Mergers and Acquisitions: Empirical Evidence from Indian Cases

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ABSTRACT

Mergers and Acquisitions (M&A) are the important business strategies for the growth and development of the companies. M&A have been racked up over the years, both in volume and value. There are different types of M&A deals and each deal is unique in nature. So, the motives behind each deal differ one from the other. Thus, a single theory is not enough to explain the motives for mergers, acquisitions or takeovers. The literature suggests various theories of mergers that explain different motives for which an M&A deal can take place. The motives can subsequently lead to increase, decrease or status quo in value. This paper discusses the theoretical foundations of M&A by making a detailed analysis of prior studies for each and every type of theories of M&A and its impact on the performance of companies in the post M&A period. The research method to carry out the study is that the study is made by revisiting reviewing and synthesising the academic literature on diverse theories of M&A and have reassessed various past studies to know various motives for which companies go for the M&A strategy. The analysis of various studies is made to get a direction to look into empirical evidence of pre and post M&A performance in Indian M&A cases to know whether managers are going for value enhancing mergers or motivated by hubris taking practical examples from real corporate world. The review results show that different companies have different motives to go for M&A. Very few cases of M&A were found on hubris motive. Companies mainly go for M&A to have synergy gain through the combined firm. The practical implication of this study is that managers can know M&A as a financial and investment decision is worthy or not to achieve their M&A goals and then reassess and redefine their strategic alternatives to achieve growth.

Keywords: Mergers, Acquisitions, Theory, Diversification, Synergy, Strategic realignment, Undervaluation, Information and signalling, Agency problems and managerism, Hubris, Free cash flow, Market power, Taxes

JEL Classification Code: G34

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INTRODUCTION

Mergers and acquisitions (M&A) are the important business strategies for the growth and development of the companies. M&A have grown over the years both in volume and value. There are different types of M&A deals and each deal is unique in nature. So, the motives behind each deal differ one from the other. Thus, a single theory is not enough to explain the motives for

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mergers, acquisitions or takeovers. The literature suggests various theories of mergers that explain different motives for which an M&A deal can take place. The motives can subsequently lead to increase, decrease or status quo in value.

This paper made literature survey and presented the various theories of M&A that explain the motives behind the companies for going into M&A transactions. This paper also investigates the impact of M&A on performance based on the theories related to M&A. This a conceptual paper based on various past studies carried out in Indian and International arena. The theories of M&A discussed in the paper are strategic realignment theory, undervaluation theory, information and signalling theory, agency problems theory, managerialism theory, free cash flow theory market power theory, tax consideration, redistribution and hubris hypothesis. The practical cases observed in the Indian M&A environment in relation to the various theories are also illustrated in the paper.

The rest of the chapter is organised as follows: Section 2 Shows Definition of Mergers and Acquisitions Section 3 Shows Theories of M&A: Synthesis of Prior Research Section 4 Shows Summary and Conclusion.

DEFINITION OF MERGERS AND ACQUISITIONS

When two or more firms are integrated into a legal unity, this is referred as a merger strategy. In case of acquisitions, two or more firms join together, but the target firm is not integrated into the acquiring firm, rather, it remains as its subsidiary without losing its existence (*Shim and Okamuro, 2011*). A merger or acquisition is a transaction where two or more companies are combined to turn out to besingle firm (*Westonand Copeland, 1992*). A merger is a pooling of the interest of two companies into a new enterprise, requiring the agreement by both sets of shareholders. Acquisition is a purchase by one company of a substantial part of the assets or securities of another, normally, for the purpose of restructuring the operations of the acquired entity. The purchase may be of all or a substantial part of the target's voting shares or of a division of the target firm (*Daga, 2007*).

The legal definition of amalgamation comes under Section 21B of Indian Income Tax Act 1962 which means merger of either one or more companies with another company or merger of two or more companies to form one company in such a manner that (a) all the assets and liabilities of the target company/ companies become the assets and liabilities of acquirer company, (b) shareholders holding not less than 75 per cent of the value of shares in the target company (other than shares which are held by, or by a nominee for, the transferee company or its subsidiaries) become shareholders of the acquirer company, (c) the consideration for the amalgamation receivable by those equity shareholders of the target company who agree to become equity shareholders of the acquirer company is discharged by the acquirer company wholly by the issue of equity share in the acquirer company, except that cash may be paid in case of any fractional shares, (d) the business of the target company is intended to be carried on, after the amalgamation, by the acquirer company and (e) no adjustment is intended to be made in the book values of the assets and liabilities of the target company when they are incorporated in the financial statements of the acquirer company except to ensure uniformity of accounting policies.

Mergers are done through absorption where either the acquirer or target loses its existence and another remains active. For example, in 2008, Dolphin Laboratories (target) merged with Intas Pharmaceutical Ltd. (acquirer). Later, Dolphin Laboratories lost its existence and Intas Pharmaceutical Ltd. remained. Similarly, in 1988, Tata Fertilizers (target) was merged with Tata Chemicals (acquirer). Later, Tata Chemical remained and Tata Fertilizers lost its identity. Mergers done through consolidation are those where acquirer and

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target both lose their existence and a new company is created. For example, HCL Limited was formed out of merger of Hindustan Computers Ltd., Hindustan Instruments Ltd., Indian Software Company Ltd. and Indian Reprographic Ltd. M&A deals are done through acquisitions where two or more companies they remain independent, separate legal entities, but there is change in the control of the companies. For example, Bliss GVS Pharma (acquirer) took over 70 percent stakes in Kremoint Pharma Pvt. Ltd. (target) in 2012. Similarly, Dalmia Cement (Bharat Ltd.) (Acquirer) took over 50 percent stakes in the equity of Calcom Cement India Ltd. for Rs. 238 crore.

There are various types of M&A. A horizontal merger occurs when two companies who are competitors combine together. A vertical merger occurs when two companies are in a buyer and seller relationship. A conglomerate merger is one where the companies are neither competitor nor are in buyer and seller relationship (*Gaughan, 2007*).

THEORIES OF M&A: SYNTHESIS OF PRIOR RESEARCH

There are various theories of M&A, which explain the various motives for which companies go for M&A deals. The syntheses of prior research on theories of mergers are made to bring insight to the potential benefits of mergers.

Value creating theories of M&A explain that managers of firm make every effort to create value of the firm and look after the shareholders' interest. So the mangers go for those M&A deals that create synergy from the combined firm. It is expected that the acquirer and target firm would get positive returns out of the M&A deal because of synergistic benefits. M&A deals do not create value where synergy from M&A is lower than the takeover premium and integration costs. Such theories are explained by hubris activities and agency problems (*Vijgen, 2007*).

Value decreasing merger occurs because of pre-emptive motives of the bidder firm. When a firm observes that its competitor makes bid for a particular target and would make gain out of the deal by saving cost or increasing efficiencies, the firm would prevent the deal by making the bid for the target. In this process, the firm prevents the competitor to be successful in making the deal and thereby avert itself from having reduced profit and preventing the competitor to enjoy M&A benefits like reduced cost of production. But in trying to prevent the deal, the firm overpays for the target firm compared with the amount of gain it would earn and thus, merger creates no value (*Molnar, 2002*).

Weston *et al.* (2011) have explained the theories of mergers and tender offers based on three aspects namely (1) the reason behind occurrence of a merger, (2) the expected impact of mergers and tender offers on the value of the firm and (3) explaining the merger process. The wealth effects of M&A announcement are explained by M&A motives like economies of scale and transaction costs. Gohlich (2012) discussed on four theories of mergers namely, synergy theory, agency theory, market power theory and strategic similarity theory.

There are two types of explanations for takeovers and mergers: value maximising and non-value maximising explanations. The value maximisation explanations include (1) efficiency theories like synergy gains and agency cost reduction, (2) wealth transfer theories like bondholder expropriation, expropriation from labour, market power and tax benefits and (3) inefficiency theories like under-pricing and market myopia. The non-value maximising explanations include (1) diversification, (2) self-aggrandisement, (3) free cash flow and (4) hubris and the winner's curse (*Romano, 1992*).

Giannopoulos (2008) has grouped various theories of mergers into economic, management, strategy and synergy motives. The author has divided the motives

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into two parts – first part includes motives related to pre-merger activities and the second part includes post-merger activities. The pre-merger motives are linked with increasing the profits of company, enhancing the market power, achieving economies of scale, reducing costs and making barriers for entry for new firms. With such motives their pre-merger activities include searching for potential target company, linking all pre-merger performance with actual post-merger performance and proper implementation. The post-merger activities include asset divestiture, resource deployment, cost savings and revenue enhancement.

Motis (2007) have clubbed together the various motives of M&A into two theories. The first group labelled as industrial organisation theories that include motives like increasing market power, improving efficiency and defensive or pre-emptive motives. These motives look into value increasing activities of the firm that lead to an increase in future profits and thus enhance shareholder value. The second group labelled as corporate governance theories include motives like solving agency problems, resolving internal inefficiencies and capital market imperfections. These motives do not look into the interest of shareholders, but the interest of managers of firms. So, mergers done with such motives are not value-increasing activities for the firm rather increase the wealth of managers.

Gorton *et al.* (2009) have proposed a theory of merger that explains three aspects of size, namely (1) mergers occur in certain industries as the firms try to increase their size, (2) the size of industry is the main reason behind occurrence of mergers in waves and (3) the deal is over-paid by large acquirers. Large acquirers make more profit and medium size acquirers make more acquisition deals.

Weston *et al.* (2011) have shown that theories of M&A can be classified into three sections: (1) mergers as value enhancing activities, (2) mergers as value diminishing activities and (3) mergers with no effect on value. M&A are value creating as those are done with three motives, namely (1) achieving synergy, (2) reducing transaction cost and (3) disciplinary motives. Coase (1937) suggests that mergers are value-increasing activities as M&A bring with it new technology that helps in reducing the cost of transactions involved in the market as well as inside the firm like production cost. It is also observed that M&A create synergy. Bradley *et al.* (1983) give the explanation for this by stating that synergies occur because of economies of scale, involvement of effective management, improvement in techniques of production and complementary resource being used together. M&A improves the firm performance by involving the management teams of the acquirer company in the management of target company that was not doing well before M&A because of inefficient managers.

M&A are value destroying activities. Jensen (1986) argues that the value of a firm in the post M&A reduces because of the free cash flow theory. According to the theory, as the mangers have excess cash with them, they would find an M&A as a source of investment for those cash, and without really estimating the synergy out of the M&A deals, they invest the idle cash thus resulting in a failure of merger. Shleifer and Vishny (1989) states that management entrenchment is another reason for value deduction of the firm.

Sometimes, mergers are done even if it has no effect on firm's value; rather the ultimate effect is zero. This happens when the managers of the acquiring firm are too much optimism about the synergy to be derived from M&A that result in the winner's curse while over-bidding for a target firm. It is just a matter of wealth transfer from the bidder to target firm (*Weston et al., 2011*).

The theory of efficient mergers and markets for corporate control suggest that M&A are done for various reasons like personal motives of managers, mistakes done during restructuring, and to prevent any takeovers, deals are also being done (*Kwoka and Pollitt, 2007*). A new theory for mergers and

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divestitures suggest that mergers are done with the motive of getting finance where firms are unable to finance marginally gainful short-term projects as stand-alone entities because of agency problems between managers and shareholders. A conglomerate merger helps to get financing for such projects. Once the project earns profits out of financial synergy, acquirer divests to avoid the coordination cost (*Fluck and Lynch, 1999*). M&A deals are done because of stock market mis-evaluation and the market timing ability of the manager (*Zhao, 2006*).

The Q theory of investment also explains the reason for why companies go for M&A. According to this theory, one company buys another company because M&A is a high fixed cost and low marginal adjustment cost activity. Thus, a firm going for M&A leads brings better Q ratio compared with the direct investment. The second reason is that a firm typically wastes its free cash on M&A rather than internal investment. Sometimes profitable reallocation opportunities also results in M&A activities (*Jovanovic and Rousseau, 2002*).

The theories of M&A can also be explained from the point of view of the target and acquired firm getting benefit of improved performance through M&A. These are (1) from the target firm point of view: inefficient management hypothesis, size hypothesis, under valuation hypothesis and price earnings ratio and (2) from acquiring firm point of view: capital structure, firm size, management performance and free cash flow hypothesis.

The different theories of M&A are discussed in detail in the below subsections.

Efficiency Theory

Efficiencies can be gained through M&A. Efficiency is enhanced by taking advantage of specialised skills or target's management, eliminating the idle resources, sharing expensive technologies between the acquirer and target, promoting products that are complementary to both companies, reducing transaction cost and re-allocating existing expenses (*Wolfe et al., 2011*).

The efficiency theory that suggests that mergers occur because two firms have different strengths and weaknesses and different efficiency levels. This is known as differential efficiency theory. Through merger the efficiency of management of one company is transferred to an inefficient management firm which results in both social gain and private gain because it not only improves the performance of the poorly performed company but also saves the resources of the economy. It is also called the managerial synergy hypothesis because the excess managerial capacity is utilised in a company where there is a lack of such efficient managerial resources. Differential efficiency theory is the basis for horizontal merger. If firms carry out the business activities in a similar line of business, they become potential acquirers. The companies that are able to identify and segregate the business activities that are performing above and below average performance can improve the performance based on such information. Here, firm involves superior managers as they have more experience in a particular line of business activity (*Weston et al., 2010*).

Inefficiency management theory is another variant of efficiency theory, which relates to the ability of managers in improving firm performance. It suggests that M&A increase efficiency of the company by removal of inefficient management. Kumar and Rajib (2007a,b,c) also support the inefficient management hypothesis and agree that mergers provide mechanisms to remove the inefficient management of the target enterprise. Inefficient management theory is the basis for unrelated mergers. It is not entirely different from differential efficiency theory. However, it states that the management has potential but they do not utilise their full potential. Hence, the managers from another firm who are more efficient can control and manage the assets of the company more efficiently and effectively than the current inefficient ones (*Weston et*

Table 1: Cases of companies that went for M&A for efficiency

M&A deals	M&A motives
Holcim Ltd. acquired ACC Ltd. (2007)	To organise talent exchange programmes at the management levels in Holcim and ACCTo employ innovative technologies in manufacturing and information technology that would result in higher energy efficiency and product development
Facebook acquired Little Eye Labs (2014)	To take its mobile development to the next level by leveraging Facebook's world-class infrastructure and different applications
United Breweries (Holdings) Ltd. acquired associated Breweries and Distilleries Ltd., Mangalore Breweries and Distilleries Ltd., Empee Breweries Ltd. (EBL) (2010)	To pool managerial skills and utilisation of valuable resources by carrying out operations in a single entity
Merger of ABG Shipyard Ltd. with Western India Shipyard Ltd. (2007)	To have expertise in rig and ship repairing to existing business and to get receive big and quality repair orders for both ships and rigs

Source: Author's compilation from various online sources.

al., 2010). Table 1 shows the Cases of companies that went for M&A for efficiency.

Synergy Gain Theory

M&A are done to get synergistic benefits out of the combined firm that is of acquirer and target together. The value of combined firm is likely to be greater than the acquirer and target firm separately. The gains arise out of the financial or operating synergies though economies of scale of operations. It means when the two firms combine, their fixed cost is distributed among the large scale of productions leading to less fixed cost. Apart from the economies of scale, there is another variant of it which is called as economies of scope where the complementary resources of the acquirer and target firm are combined to bring synergy gains. For example, the acquirer is good at marketing and target is good at its research division, they combined to produce a new product and market it.

Most of the M&A have a motive to increase the size of the company. This is possible when two firms combine to get the benefits of economies of scale and scope. Economies of scale occur in various ways. It may occur because of the huge scale of operation or it may occur by holding inventories or through specialisation. Economies of scope occur when a company manufactures some related goods at lower cost as it enjoys the experience of dealing with the existing products (*Romano, 1992; Weston et al., 2010, 2011*). Table 2 shows the Companies that went for M&A for synergy gains.

Diversification

Diversification means expansion in terms of either geography or product range or both. Diversification and its attached benefits like reputational benefits, preserving reputational capital and demand for diversification by managers and employees. It helps in increasing the corporate debt capacity and decrease the present value of future tax liability. These results in stability of cash flow even if there is variability through mergers. Mergers are considered better route for diversification than internal growth because the timing and availability of requisite resources do not match through internal growth (*Weston et al., 2010*). Table 3 shows the cases of companies that went for M&A for diversification.

Strategic Realignment Theory

Economic environment is dynamic in nature. Companies need to realise their strategies depending on changes in the economic environment. Changing and uncertain business environment is also another reason for mergers. M&A can occur because of strategic realignment to changing environment. Companies go

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Table 2: Companies thatwent for M&A for synergy gains

M&A deals	M&A motives
Prism Cement Ltd. acquired Milano Bathroom Fittings Pvt. Ltd. (2010)	To increase the manufacturing capacity of the plant in Baddi, Himachal Pradesh to six lakh pieces per annum from three lakh pieces per annum to meet the growing demand for both products
Hindalco Industries Ltd. merges Indo Gulf Corpn. Ltd. (2002)	To increase revenues around Rs. 6,000 crore
Mahindra and Mahindra Ltd. acquired Ssangyong Motor Co. (2010)	To leverage the combined synergies (Mahindra' sourcing and marketing strategy + Ssangyong's strong capabilities in technology) by investing in a new Ssangyong product portfolio to gain momentum in global markets
Steel Authority of India Ltd. merged Neelachal Ispat Nigam Ltd. (2005)	To create better value through synergy and growth through the wider product mix with improved quality and enhancements in terms of grades and dimensionsTo expand and produce steel and other value added products to face the competitive worldwide market

Source: Author's compilation from various online sources.

Table 3: Cases of companies' thatwent for M&A for diversification

M&A deals	M&A motives
EID Parry acquired Nutraceuticals Co, Valensa International (2008)	To access market in the United States and European Union countries that would help in cross selling in the global carotenoids market
Hindustan Unilever Ltd. with International Bestfoods Ltd. (2001)	To make their entry into untapped markets as buying old brands could be simpler and more cost-effective than launching new green field brand
Raymond Ltd. with Raymond Calitri Denim Ltd. (2000)	To acquire the files and tools division of HGI industries(HGI Industries Limited, a flagship company of the Aditya Birla Group, ranks among India's largest private sector companies.)
Kamadgiri Fashion Ltd. with Stripes Apparels Ltd. (2009)	To go for forward integration and expansion planTo expand production capacity to more than three lakh garment pieces per month as these garment factories are supplying garments mainly to Pantaloon retail and also doing some business for Raymond as well
Dabur India Ltd. with Fem Care Pharma Ltd. (2009)	To have a strong foothold in the high-growth skin care market with an established brand name FEM(Fem Care Pharma Limited brand)

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for M&A as a motive to growth through diversification in a long-run period. M&A as a part of the strategic plan is done with proper analysis of the environment around which the firm operates. So, M&A can be done for various strategic goals like enjoying the economies of scale, acquiring managerial skills depending on the timing of the plan or the requirements of the firm. Growth through merger is more rapid than any other internal growth strategy (*Weston et al., 2010*). Table 4 shows the companies that went for M&A with strategic realignment motive.

Undervaluation Theory

There are various studies that have shown how undervaluation of target firms can be the motive behind M&A. Undervaluation of the target firms can be result of inefficient managers who are not efficient to manage the operations of firms up to its potential. Even if the target firm's management is efficient, the acquiring company may still perceive to be undervalued with the help of inside information. In such case, they bid at a higher price than the prevailing price in the market. In certain cases the asset of the

Table 4: Companies that went for M&A with strategic realignment motive

M&A deals	M&A motives
Merger of Tata Motors Ltd. with Tata Finance Ltd. (2005)	To grow its auto financing business and offer complete solutions in line with the global best practices in the auto industry to enable the company to provide a hedge against the cyclicality of the automotive business
Merger of Gabriel India Ltd. with Stallion Shox Ltd. (2002)	To generate synergies in operations and enable Gabriel India to modernise technology, R&D and design base in the Stallion Shox operations after the merger
Shinny Ltd. acquired Apar Industries Ltd. (2006)	To increase capacity of its three lines of productions to fulfil the company's need for more working capital because of high prices of raw materials
Merger of Novartis India Ltd. with Ciba CkdBiochem Ltd. (2001)	To protect from losing a secure and a quality source of rifampicin as CCBL (Ciba Ckd Biochem Ltd.) has been under the danger of becoming a sick company
EID Parry acquired Nutraceuticals Co, Valensa International (2008)	To have access to science-based product patents, extraction technology

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company is undervalued which is reflected from the difference in the market value of assets and their replacement cost. This leads to undervaluation of company. The cost of buying and building similar assets is likely to be higher (*Weston et al., 2010*).

There are various aspects of undervaluation theory. The first one is the short-term myopia problem. Market participants like institutional investors give importance to short-term returns not long-term returns. Hence, companies that make long-term investment programme are undervalued and become attractive targets. There is another issue in undervaluation theory when the market is below replacement cost. The companies prefer a diversification route for entering into new product or new market. In this regard, inflation plays an important role. When the inflation reduces, there is an improvement in the business outlook. Inflation leads to higher current replacement costs of assets than their book values. These two effects lead to decline in the Tobin's q ratio (*Weston et al., 2010*). Under valuation hypothesis states that the firms with low market to book ratios are viewed as undervalued and are potential targets (*Kumar and Rajib, 2007a,b,c*). Table 5 shows the companies that went for M&A for buying undervalued target.

Information and Signalling Theory

This theory suggests that two different investors behave differently when they have different information. The merger announcement is a source of information and signal to market participant about the possible impact of deal on firm value. The announcement of merger event would signify that the value of target would increase or double, or the management team would be removed by the new owners. It also sometimes signifies that there would be an increase in the cash flows and future values. Thus, the announcement of a merger or acquisition would signal that in future there would be increase in future value of the bidder firm (*Weston et al., 2010*).

There is an extension to the signal theory which states that because of information asymmetries, targets

Table 5: Companies that went for M&A for buying undervalued target

M&A deals	M&A motives
CiplaMedpro Shareholders Back Buyout By India's Cipla (2013)	The shareholders of South Africa's CiplaMedpro made a $488 million takeover offer from India's Cipla Ltd. and the price was undervalued

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enhance the sellers gain by reducing the acquirer's offer price. The implication is that since the target engages in inter-organisational relationships, there is gain to sellers, as it acts as a signal (*Reur et al., 2012*).

The target shares and assets may be undervalued because of their higher value for an alternative owner who may place assets at a higher and better use. If one outsider can add value, then another potential new owner may also add value. When managers learn about the potential for the discipline of a merger, they institute pre-emptive steps to initiate the discipline by themselves. The form of mergers can be used to glean information about bidders and targets. A bidder that uses common stock rather than cash may signal that the bidder's own stock may be overvalued, or it may signal that the bidder is unsure of the target' value and wishes target shareholders to share in the risk of potential mis-estimation of the target's value Table 6 shows the cases of companies that went for M&A because of the information and signalling theory.

Agency Problems and Managerism Theory

An agency problem occurs when there is a conflict of interest between the managers (agents) and shareholders (principals) of the firm. Weston *et al.* (2010) mentioned that Jensen and Meckling (1976) have discussed regarding the possible repercussion of agency problems. For example, a manager is considered as the agent of the company and shareholders. A manager who owns less percentage of shares gives less time to the company's wealth-creation activities. Such activities of managers cannot be monitored by all organisations because it would require large resources in the form of incentives to supervise the managerial activities. So, the agency problem involves some costs to companies like cost of structuring of contracts, the cost of monitoring the activities of agents, the cost of preparing bonds with agents to make optimum decisions for company, residual cost because of difference in decisions between agents and principals.

According to Fama and Jensen (1983), a firm in order to retain the interest of shareholders, separates the ownership and control rights from managers, and if they make any major decisions like M&A they need the approval of shareholders. However, if these strategies do not work, then takeovers can be the solution to these agency problems. A takeover is an external control device to control the agency problems (*Manne, 1965*). A takeover through tender offer or a proxy fight enables outside managers to control decision process of the target firm by bypassing the existing managers and board of directors. A merger as a takeover threat acts as control measure, as it is viewed that the firm performance is not good because of inefficiency of managers. Thereby, it leads to removal of such managers after such merger.

There is another unusual view that mergers do not help in solving agency problems. Rather, it creates more of agency problem which is termed as managerialism. Mueller (1969) explains the concept of managerialism that states that managers are motivated to increase the firm size and resources under their command. Table 7 shows the Companies went for M&A to solve agency problems and managerism.

Table 6: Cases of companies that went for M&A because of the information and signalling theory

M&A deals	M&A motives
Kotak Mahindra-ING Vyasa (2015)	The deal signals that leverage ING's digital banking strengths, evident from the fact that ING was among top two or three consumer banks in Germany with zero branch presence. ING group was very comfortable with deal. It is a way of signalling contrary to what you may have felt that this is not a distress deal at all. The combined synergies a big signal that ING group is committed to make the merger work, to have a 1 year lock in post merger as a sign of commitment

Source: Author's compilation from various online sources.

Table 7: Companies went for M&A to solve agency problems and managerism

M&A deals	M&A motives
Sun-Taro merger deal	The deal was done, but later it was making Taro as virtually a negative cash company which indicates that deal was done by mangers without properly investigating its strategic fitness

Source: Author's compilation from various online sources.

Hubris Hypothesis

The literary meaning of hubris is pride or arrogance, which leads to overestimation of one's own capabilities, when someone is in a power or position. Roll (1986) postulates that managers make an overestimation in evaluating the target firm value and synergy benefits from mergers due to excessive pride, animal spirits or hubris. The managers while making valuation of targets assume that their estimations are correct even if there is no value to be created out of the deal.

In a takeover deal, the bidder (acquirer) first spots a prospective target and makes valuations of its assets to know if it is a potential target to buy. If the value of the target firm is below the market price, then no offer is made. If the value of the target firm is above the market price, then a bid is made. The target enters takeover sample. If there are no synergies or benefits, then valuations take into account the current market price. Offers are made when valuations are too high. However, sometimes bidders make mistake by offering takeover premium where there is no synergy out of the deal (*Weston et al., 2010*). Hubris need not be always taken in a negative sense. Sometimes, the intensions of managers may be good, but they make wrong decisions while valuing the target (*Weston et al., 2010*).

Mergers and takeovers are the means for efficiently redistributing the resources of the company while curtailing the transaction costs and maintaining the values of the organisation (*Weston et al., 2010*). Hubris can arise because of over confidence gained in previous successful M&A. As a result, subsequent M&A can be unsuccessful (*Kumar and Rajib, 2007a,b,c*). Shareholders of the bidding firms do not incur a loss on merger announcements and thus, cannot be considered as a risky investment for shareholders. On the other hand, the target firm shareholders benefit from higher cumulative abnormal returns around the announcement for the merger event. Hence, this could be considered as a part of the hubris hypothesis (*Deo and Shah, 2011*).

Studying the M&A announcement effects taking the degree of controlling interest of the target firm

Table 8: Cases of companies that went for M&A for hubris hypothesis

M&A deals	M&A motives
L&T and Grasim (2003)	Grasim is taking every possible step to enhance the value for its (Grasim's) shareholders, L&T's management (read majority shareholders) seem to be pursuing a course of value destruction. A course that is neither in their own interest, nor in that of the minority shareholders. It can be considered as a deal done because of hubris
Daiichi Sankyo acquired Ranbaxy (2008)	In 2008, Daiichi Sankyo paid $4.6 billion for 63.4% of Ranbaxy. The size of deal was very big for which it was pursued and later Daiichi Sankyo hasn't been able to understand the generic space or run the business successfully
Apollo's bid for Cooper (2013)	The aim of deal was to transform itself into the world's seventh-largest tyre maker. But it was risky because of the larger size of the target, the results may be negatively affecting the ability of Indian family-run firms to execute large cross-border deals despite their need to search for growth abroad

Source: Author's compilation from various online sources.

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(*Sugiarto, 2000*) found that it does not matter whether there is more or less than 50 per cent of controlling interest, as there is a decrease in the target returns, whereas the increase in acquirer returns which is inconsistent with the hubris hypothesis. So, M&A is not a risky investment for acquirer firm. Table 8 shows the cases of companies that went for M&A for hubris hypothesis.

Free Cash Flow Theory

Free cash flow and agency cost are very much related as merger motive. Free cash flow according to Jensen is the cash flow in excess of amounts required to fund all the projects that have positive net present values when discounted at applicable costs of capital. Jensen (1986, 1988) argues that agency cost which is the outcome of conflict between the agents and principle, that is managers and shareholders over the free cash flow are one of the important causes of any takeover activity. According to Jensen, there is always a conflict of interest when there is a decision to be made regarding the corporate strategy that would depend upon the wealth creation. Agency cost occurs as discussed above and there is no perfect solution for it. When the agency cost is huge, takeover helps the cost to be reduced. Instead of keeping the free cash flow, it should be distributed to shareholders. When the cash is distributed back to shareholders, the managers lose control over the resources and they lose power that makes them to seek for new investment opportunities. Similarly, when additional funds are needed, it is better to go for debt rather than equity. In this way, managers will be forced to earn cash flows to repay the debt (*Weston et al., 2010*).

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As per free cash flow hypothesis, stock prices of firms with positive free cash flow should increase over time as management is pressurised to increase payouts to corporate shareholders. If management fails to increase payouts and instead wastes free cash flow on unprofitable investment spending, further deterioration of firm value can take place (*Kumar and Rajib, 2007a,b,c*). For example, Samsung Electronics Co. Ltd. aims to use its $56 billion (2014) cash pile to fund growth including acquisitions. Table 9 shows the Companies that went for M&A for free cash flow.

Market Power Theory

There is another school of thought that states that mergers are done with the motive of increasing the market shares of the firm. With enhanced market shares, acquirer would yield more power in the market. But increasing market power through mergers is not always accepted because it would lead to concentration of firms in the industry. High-concentration would lead to either monopoly in the marketplace or intense competition. The intense competition occurs among the largest companies in concentrated industries for their prices, outputs, type of products, quality of products and services. The market power theory argues that with the increase in the size of the firm, the market power increases. In case of horizontal mergers, decrease in the number of firms will increase familiar interdependence, and there would be collusion among the rest of the firm in the industry (*Weston et al., 2010*) Table 10 shows the cases of companies that went for M&A for market power.

Table 9: Companies that went for M&A for free cash flow

M&A deals	M&A motives
Neelachal Ispat Nigam Ltd. merged with Konark Met Coke Ltd. (KMCL) (2004)	To utilise an amount of Rs. 35 crore this is lying unutilised in the cenvat account in KMCL
Wipro acquired US-based mortgage services company Opus Capital Market Consultants for $75 million (around Rs. 465 crore) in December 2013	To utilise their large and increasing cash piles, M&A is considered better for capital allocation rather than a greater return of capital to shareholders through dividends and buybacks

Source: Author's compilation from various online sources.

Table 10: Cases of companies that went for M&A for market power

M&A deals	M&A motives
Himadri Chemicals and Industries Ltd. acquired Team Paramount Ltd. (2006)	To expand its presence in south-east Asia and other parts of the world as anti-corrosion products and coal tar have high demand outside India
Merger of Ultratech Cement Ltd. with Samruddhi Cement Ltd. (2009)	To have 20 per cent of market share in India
Ballarpur Industries Ltd. merged Paperbase Co. Ltd. (2002)	To make it the largest player in the domestic tissue paper market by capturing a significant share in South and West India
Sanmar buys US firm Matrix Metals (2008)	To create one of the largest specialty casting groups in the world To meet almost any North American customer's casting requirements and create new business opportunities

Source: Author's compilation from various online sources.

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Taxes

M&A are also done because it minimises the tax considerations. Firms go for mergers by looking at alternative ways that reduces tax. So, this motive is not so important if they find another way of getting tax benefits. Mergers for tax considerations facilitate more efficient behaviours to wipe out the losses. A tax is a motivating factor for the firm to go for mergers but is not a significant factor in explaining the merger. Tax benefits can be achieved in different ways: (a) An acquirer by acquiring a growth firm, with small or no dividend payout and selling it after its growth, can help in realising the capital gains. There would be substitutions of capital gain taxes to ordinary income taxes. (b) An acquirer with huge profits can buy a firm with accumulated losses. Then the combined firm has less profit and there would be tax reduction. (c) An acquirer by acquiring firms can also benefit from a step up basis for depreciable assets, based on older historical costs during the period of inflation. The step up basis for depreciable assets leads to competition among the bidding firm and thus, premium is paid for the target firm. The high market values are then used as a tool for tax purposes (*Weston et al., 2010*). Table 11 shows the cases of companies that went for M&A for tax considerations.

Redistribution

Redistribution theory states that M&As are done for tax benefits, market power, extractions from bondholders, breach of trust with labour and shifting pension costs to the government (*Ahern and Weston,*

Table 11: Cases of companies that went for M&A for tax considerations

M&A deals	M&A motives
Merger of Ashima Ltd. with Ahmedabad New Cotton Mills Co. Ltd. (2001)	To give Ashima tax benefits, as the old mill had accumulated losses of Rs. 32 crore worth
Merger of Indo Rama Synthetics (India) Ltd. with Indo Rama Petrochemicals Ltd. (IRPL) (2006)	To bypass some taxes while purchasing raw materials from IRPL
Merger of Mirc Electronics Ltd. with Onida Savak Ltd. (2005)	To utilise tax benefits accruing to it on merger, on account of income tax losses of approximately Rs. 54 crore and sales tax benefits of about Rs. 14 crore available to Onida Savak Ltd.
Neelachal Ispat Nigam Ltd. merged with Konark Met Coke Ltd. (2004)	To save the sales tax on inter-company sale of metallurgical coke and blast furnace gas in the merged entity
Indian Aluminium Co. Ltd. merge Foils Ltd. (2001)	To avail the tax benefits arising out of the acquisition

Source: Author's compilation from various online sources.

2007). Because of M&A, redistribution of wealth and income among shareholders can take place. When taxes are saved because of merger or acquisition, redistribution takes place from government as tax collector to the firm. It can take place in other different forms. Reduction in employee cost because of M&A is termed redistribution of income from employee to shareholders. The gains achieved through mergers essentially go to shareholders. This is redistribution of income or wealth from other stakeholders to shareholders (*Weston et al., 2010*). All the M&A are not value enhancing in nature. Some M&A create value whereas other redistributes the value from one stakeholder to another. So, economic efficiency is not always the motive of merger rather the stock market under valuation acts as the merger motive (*Bondt and Thompson, 1992*). Table 12 shows the cases of companies that went for M&A for redistribution of wealth.

Table 13 summarises the theories and motives of M&A.

Table 12: Cases of companies that went for M&A for redistribution of wealth

M&A deals	M&A motives
Air India merger with Indian Airlines (2007)	To reduce the workforce per aircraft cost which was 16% of total costs [Air India-214, Malaysian Airlines-230, Virgin Atlantic-282 and KLM-220]
Merger of Vedanta companies	To distribute a part of companies free cash pile among shareholders through a special dividend

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Table 13: Summary of theories of mergers and acquisitions

Theories of M&A	Motives behind the M&A	Impact on firm values after M&A
Differential efficiency theory	Management of a more efficient acquiring firm can bring up the level of efficiency of the acquired firm, providing both social and private gain	The efficiency level would increase in the economy by increasing the efficiency of companies through such mergers
Inefficient management theory	Mergers serve as a means of providing discipline to the managerial markets where the only way to get rid of inept management is through taking over the company	Performance improves above average performance
Synergy gain theory	Achieve economies of scale and scope through operating synergy. Financial synergy reduces cost of capital, benefit from coinsurance effect, lower flotation and transaction costs	M&A are profitable for targets not for the bidders. Value is added
Pure diversification	Position the firm in high growth products or markets through new product/current market, new product/ current market, current product/new market	Firms have poorer performance than the industry
Strategic realignment	Acquire capabilities to adapt more rapidly to environmental changes than could be achieved if developed internally	To cope with sudden technological, regulatory and political change, mergers bring positive benefits compared with internal growth
Undervaluation	Acquire assets more cheaply when the equity of existing companies is less than the cost of buying and building the assets	Performance of firms improves
Information and signalling	The tender offer sends a signal to the market that the target company's shares are undervalued and hence, signal information to the target management to become more efficient	Future cash flows values increase

Table 13 cont..........

Theories of M&A	Motives behind the M&A	Impact on firm values after M&A
Agency problems	Replace managers not acting in the best interest of the owners	Acquiring firm incurs losses and thus M&A are profitable for targets not for the bidders
Managerialism	Increase the size of the company to increase the power and the pay of the managers	M&A are profitable for targets not for the bidders. Opposed to it, some say that managerial theory of mergers does not lead to failure of M&A in the market
Free cash flow hypothesis	When the agency cost is large, while making the decision regarding the choice of strategy over the free cash flow, takeovers helps to reduce them	Acquirers get positive abnormal returns in the pre-acquisition period or negative returns in the post-acquisition period
Market power	Increase market share to improve ability to set prices above competitive levels	Value gains from merger results from increase in market power rather than from increase in efficiency. This gain to shareholders is received at the cost of consumers and owners
Tax consideration	Obtain unused net operating losses and tax credits, asset write ups, and substitute tax gains for ordinary income	Tax factors create gains to shareholders at the expense of the tax collector
Redistribution	Gains are redistributed to shareholders from all other stakeholders	Increase in value in mergers. Gains to target shareholders
Hubris hypothesis	Acquirer believe their valuation of target more accurately than the market's causing them to overpay by estimating synergy	Acquirers get negative returns. M&A are profitable for targets, but not for bidders

Source: Amihud *et al.* (1986), Jensen (1986), Romano (1992), Lang and Stulz (1994), Vijgen (2007), Wang (2007), Weston *et al.* (2010) and De Pamphilis (2010).

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SUMMARY AND CONCLUSION

This article attempts to look into the academic literature on diverse theories of M&A and have reassessed various past studies to know various motives for which companies go for the M&A strategy. These motives define the pre-merger or acquisition objectives to set benchmarks for post-acquisition performance evaluation. The M&A motive would set the direction for the companies to implement M&A and improve performance after M&A. The analysis of various studies has given direction to look into empirical evidence of pre and post M&A performance in Indian M&A cases to know whether managers are going for value enhancing mergers or not. Few cases of M&A because of hubris are observed in M&A market in Indian corporate sector.

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