

Impacts of amalgamations and takeovers



Chapter – 2: Literature Review

2. 1. Introduction

Investigators have been analyzing amalgamations and takeovers in the context of their characteristics and the impact on the development of both the entities over the past several years. In actuality, Weston et al. (2004) opine that the experts and researchers in the field have provided a large quantity of records related to the topic. There are many reasons why companies follow development policies related to amalgamations and takeovers. This permits rapid acceleration in addition to having a quick and instant approach to markets, both local and international. It is also likely to touch renowned brands, apply knowledge and skill, and widen the dimension and extent without losing time. In the sphere related to real estate, a participant (real estate firm) may want to promote a mutual organization for funding ventures on an individual basis. It may also consider entering into a joint venture with a construction enterprise in the domestic market so as to execute the venture as per assured measurements and highlighted conditions as stated by Jensen (2006).

Clients are reassured when they involve themselves with big enterprises, which have a great degree of brand reputation and remembrance. During these times, they articulate their backing, not merely as clients but also as financiers as they buy stakes so as to invest money in the enterprise. It is also possible for a company to advance by augmenting returns or managing expenses which in turn can be attained by reorganizing and reconfiguring finances apart from using creative methods and reengineering. Some

enterprises may also purchase brands, goods, and utilities to expand the goods portfolio of the enterprise.

The capability of an enterprise to undertake a development policy by reallocating its resources in creating different facets of its presence was maintained by Hogarty (2000). This could be denoted by its production unit, R&D, and through creating and promoting its brands and setting up more projects in parallel or varied spheres. Firms may also purchase extant enterprises or amalgamate with others to attain their objectives.

Amalgamations and takeovers assist in accelerating development as the roles pertaining to infrastructure, branding, and manufacturing are clearly set up. Superior mediums which endorse development comprise of contracts, treaties, and agreements for varied ventures for a pre-determined time.

All across the world, international corporates and enterprises are entering into purchases of and amalgamations with new firms, forming joint ventures and such equivalent associations on a common basis. Nearly fifty percent of the contracts pertaining to amalgamations and takeovers in India have been initiated by global enterprises. In 2005 alone, India witnessed global contracts of around 58 percent, a number which was double compared to Japan's agreements at 21 percent.

Internationally, amalgamations and takeovers entail dogmatic frameworks particular to a specific nation and the labor unions of the enterprises. Post the 1990s, economic revolutions have been occurring globally and this has seen a growing attraction for amalgamations and takeovers. The financial segment witnessed a newness which saw modifications being made to

possession and trade regulations, an increase in the disposable earnings and as a result, the capacity to discover newer marketplaces and newer chances. Firms are now fully utilizing the reduced interest rates and cost of capital. This has assisted several enterprises in broadening their scope of operations at the domestic and global levels through partnerships, associations, amalgamations, and takeovers. Additionally, the presence of many global media enterprises which publish information pertaining to contracts and partnerships on a large extent-particularly in segments related to production, cars, retail and others.

On the other hand, it is extremely crucial for companies to ensure specific advisory metrics before they perform their functions related to amalgamations and takeovers, especially in huge markets which have not been discovered. Amalgamations and takeovers also have the ability to shift the stakeholder worth affirmatively or adversely, which may result in a scenario, which eats away into the prosperity.

When local takeovers in addition to global amalgamations get transformed into deficit-making and zero-worth developing patterns, all of these experience impediments. When stakeholders are not going to benefit from such projects, the costs of shares decline and thus, such agreements must consider all the primary essentials before opting for the linked choices. The influence of amalgamations and takeovers may be favorable or harmful to the development and this may take a long time and also be extremely costly for a total revival from an impediment.

The existing segment also highlights the investigations and examinations undertaken on the topic by analysts. One needs to have sufficient data evaluation and also conduct hypothetical tests while assessing the influence of amalgamations and takeovers. Adequate links should also be deduced to comprehend the reason and impact correlations in amalgamations and takeovers in context to the criteria such as development of trade, stakeholder worth, productivity, and general performance. As the current study is linked to the influence of international amalgamations and takeovers, it is crucial to analyze the global amalgamations. Global partners who function from India while being based in the European Union framework have been examined depending on specific extant data. Additionally, domestic amalgamations and takeovers have also been analyzed.

2. 2. Theoretical Background: Mergers & Acquisitions (M&As)

2. 2. 1. Definition

Amalgamations and takeovers can be superiorly comprehended as development policies to enhance the income of the enterprise and also, its capital foundation. Sometimes, for two enterprises, with similar or dissimilar trade functions, to amalgamate on specific ranks is a superior trade choice. An amalgamation of this type assists in imparting a blend of experience and finances. A commercial amalgamation of this type functions as a solitary body between edifying impacts and worth values of a commercial amalgamation and takeover (Jensen and Ruback, 2003). Though the phrases ‘amalgamations’ and ‘takeovers’ are frequently employed collectively, they are two extremely varied procedures.

Amalgamations describe the merging of two different enterprises into a single entity. The two enterprises join each other, and shift all their resources and functions into a new one. This procedure includes the merging of all types of resources-employees, manufacturing facilities, and functions into the new entity that is shaped. The new entity shaped out of this has its individual distinctiveness, edifying representation, and groups of convictions. It is pointless to state that they are possessed by both the parties which share their resources to develop the new identity (Huang and Walkling, 2007).

A takeover is considered as the purchasing-out procedure of an enterprise by another with the goal to stimulate management of its assets, investments, and functions. Takeovers occur when a firm purchases a major share of another firm's stakes, assets, and liabilities (Weston et al., 2004). Firms experience a supplementary benefit when this occurs as they get the management apart from the functioning assets, in contrast to when they purchase merely the stakes, in which scenario they have to only compete with the other shareholders. Purchasing assets includes more expenses and offers an extensive capital foundation (Singal, 2006). Now let us consider acquisitions. This phrase also has been employed for many perspectives and is understood also. Takeover is a vague expression and though it may denote a context similar to acquisitions; the two are actually varied types of trade agreements (Jensen, 2006). A takeover is when a purchase is conducted without acquiesce or permission of the enterprise being taken over. Takeovers come with an adverse action that entails the attaining of another firm with the intent to 'manage' it. When an enterprise desires to

take over another firm, it tries to purchase all its shareholders. Takeovers are the ones which do not have the approval of the firm being purchased and they are often nearly undertaken as a hostile proposal. This now clearly explains the different expressions and implications attached to amalgamations, acquisitions, takeovers, partnerships, and associations and how their context is based in the situation in which they are being applied.

2. 2. 2. Types of Mergers & Acquisitions

Mergers can occur at parallel, perpendicular, or multinational levels. Each kind of amalgamation has not only its own typical characteristics but also a distinct impact on the work processes and trade functions.

Horizontal Mergers

When two enterprises or enterprises that have parallel trades, which amalgamate to develop an entirely novel trade enterprise, it is known as a parallel merger. The enterprises which enter into a parallel amalgamation combine their assets as individual enterprises to shape a novel entity. These enterprises are thus capable of making a more robust enterprise which has a wider capital base and greater resources. The rationale behind this is to acquire a larger market share and become a dominant force in the market (Shleifer and Vishny, 2009).

Such parallel amalgamations provide several benefits. They enable larger presence and greater range in addition to optimal performance ability to the novel entity. The two previously distinct entities now have the benefit of augmented resources capable of executing procedures in a superior method to ensure consistent supply of goods, which are of much better quality (Mitchell and Mulherin, 2006). Even in India there are a few instances of <https://assignbuster.com/impacts-of-amalgamations-and-takeovers/>

parallel amalgamations, for instance, the amalgamation between Indian carriers' which occurred between Lufthansa and Swiss International apart from Air France and KLM (Bottazzi et al., 2001).

The United Kingdom (UK) has witnessed several parallel amalgamations. In reality, the results of several investigations have depicted that nearly 60 percent of all amalgamation agreements which have occurred post-2001 have been parallel amalgamations (Firth, 2000). The same notion is also put forth by Berndt (2001). He also states that most of the amalgamations which happened post-deregulation and liberalization of the economy were parallel in character. Another instance of a parallel amalgamation like the one of Birla Cement and Larsen & Toubro (L&T) is related to the cement sector. Additionally, the amalgamation of Kingfisher Airlines and Air Deccan in addition to the one between Jet Airways and Air Sahara depict parallel amalgamations in the airlines sector. The Tatas and the Birlas are two huge corporate entities, which have amalgamated in the telecommunications sector.

Vertical Mergers

A perpendicular amalgamation is one in which enterprises which are elements in a supply chain or which function as utility suppliers or subsidiaries in the equivalent type of trade resolve to become one entity. It is noticed that such amalgamations occur when firms resolve to augment their forte in the supply aspect (Agrawal et al., 2002).

Perpendicular amalgamations manage to keep rivals away by maintaining stress and managing their supply firms. The perpendicular amalgamation is

thus capable of seizing a bigger market share for their goods while the supply group fails to back the goods of other contenders. This plan assists the enterprises to closely react to their clients' needs. The element pertaining to the rivals is capable of keeping the prices from rising as the supplies are not reimbursed for (leanmergers. com). Logically, the outcome of this action is an extremely robust management and more revenues as the firms attain an upper hand over their contenders.

An instance of perpendicular amalgamation is the one between Ford and Vauxhall who are car producers, who have acquired or purchased automobile enterprises. When Ford purchased Hertz, it was an instance of a perpendicular amalgamation (Loughran and Vijn, 2007). Another example of a perpendicular amalgamation in the telecommunication industry is that of Reliance Communication Ltd's purchase of Flag Telecom.

Conglomerate Mergers

Multinational amalgamations occur amongst two entirely varied enterprises. Such enterprises are participants at distinct degrees and have no equivalents in the good variety, markets, clients, supply chain, or any other criterion. Multinational amalgamations occur amongst such enterprises and a novel association is shaped in addition to new trade contracts. Multinational amalgamations show only one line of power or authorization, which manages the trade functions from a solitary aspect of knowledge, resources, client power, and market experience which guarantee enhanced trade after the multinational trade which occurred before (Asquith et al., 2003).

Multinational amalgamations are executed so as to diffuse the dangers over

an extensive base and thus avoid any chief impediment for the enterprise (Huang and Walkling, 2007).

Financial Acquisitions

Monetary attainments are related to the capital and fiscal aspect of trade plans such as Management Buyouts (MBOs) or Leveraged Buyouts (LBOs). Such purchases are not considered in the same context as amalgamations and takeovers (Travos, 2007).

2. 2. Stimulus for Amalgamations

A large chance to develop the value of mergers is when incentives for the same are anticipated or envisaged by investors. Investigators such as Asquith et al. (2003), Agrawal et al. (2002), and André et al. (2004) have developed comprehensive data related to the topic pertaining to the incentives for mergers. Mergers must be discouraged by varied reasons such as a superior geographic market, varied economies, superior capabilities and price efficient conduct, widening of the trade, the synergy incorporated, and shifting assets to superior administrators so as to maximize the assets and create superior results, which is the chief objective.

It has been proved that mergers and amalgamations are distinctive mediums related to financing in the context of advancement by many investigators. The chief idea or objective behind attaining a profitable investment would be important, particularly if such a concept is considered. In the event of the presence of incentives such as professions or sometimes pure respect improvement occurrences, the possibilities of investments becoming valuable, particularly when there are totally varied incentives for the varied enterprise to triumph and create the line of business. In the event of <https://assignbuster.com/impacts-of-amalgamations-and-takeovers/>

mergers, at the point when the primary incentive shapes the real advantageous investment, one has to consider the reason why the merger may seem to be priceless. A primary reason may be the lack of the expanding capability to access an unexploited market. One may anticipate a merger so as to achieve these objectives in an effortless manner (Gugler et al., 2003).

For a triumphant merger, one should ascertain aspects of robust revenues and synergies. The focus in this matter should also lie on comprehending the incentives for cross-border mergers. It is noticed that dissimilar to domestic mergers for cross-border mergers, one needs to develop an incentive evaluation (Conn et al., 2001). The FDI incentives would resort to internalization, ownership, and position advantages as good instances as mentioned by Moeller et al. (2004).

In the context of cross-border mergers, a merger is not likely to have unique ownership advantages. On the other hand, locational advantages may be unclear. Thus, in lieu of purchasing an enterprise in a totally varied geographical market, there are many idea-procedures which happen constantly. The majority of crucial internalization advantages in the instance of cross-border mergers are when products are sold overseas by one nation to another.

In the event of the incentives, the OLI framework provides a backdrop for the objective of cross-border mergers, but other factors are also very crucial. It is considered by Chen and Findley (2002) that there is a speed if the retrieval

to international markets since those from Greenfield investment cannot be equaled.

By the end of the initial ten years of the 21st century, the waves in mergers were analyzed by Danzon et al. (2004). This was later referred to as the ‘ Cross Border’ wave. In contrast to other waves of the century, Evenett explained the trends of the merger wave to be distinct. The utility segment displays how the merger wave comprises of more mergers since specific elements had become components of the ‘ Cross Border’ and more so, with the liberalization effects in addition to the industrial monetary facet, this has additionally intensified privatization. There had to be a greater milieu to assist cross-border mergers. With the chief investment, the incentives had to be linked to the dogmatic surrounding to guarantee an element of the merger wave as depicted by Evenett. For other such grounds, cross-border mergers rise as depicted by Nicholson and McCullough (2002).

When the researcher has to handle the theoretical information pertaining to mergers, he tries to present an expansive literature for better understanding. In the context of mergers, a maximized direct policy contention seems to be the most superior and is accountable for the impact of the mergers.

A reasonable facet of the investigation discusses how both, markets and clients in the market commence many types of mergers. There has also been a theoretical investigation relating to ideas such as benefit predictions, envisaged variations in the outlays, diversified and varied quantum, in addition to who will eventually gain or lose on account of mergers. These

theoretical investigations found their crux in oligopoly markets. Oligopoly markets have been the only crucial markets to utilize the rationale behind mergers opine Conn et al. (2001).

So as to manage such market situations, a firm which enjoys a monopoly generally cannot enter into a merger. In a merger of firms, there would be no impact on the market outcomes. In varied production scenarios, the strengths of demand and cost in varied types of oligopoly markets function in different ways while the emphasis of the literature is on studying mergers.

2. 3. Cross-Frontier

There are several literatures which pertain to theories related to mergers. In reality, none of these literatures actually differentiate that in the management of international merger procedures there must be variations. To achieve cross-border mergers several simultaneous investigations have been undertaken, which complement that there are several literatures dealing with the impacts of these mergers. In terms of globalization, it relies so this is a close expansion and additionally it fulfills international economy apart from varied types of market endeavours to expand international firms of their functions. With consistent methods related to cross-border mergers there is relevant contention for the perusal of “Indianization” of different segments as described by Ozawa (2002). On account of the absence of attempts in merging administrative techniques, business is the driving aspect behind communication and culture which is why different cross-border mergers were unsuccessful states Finkelstein (2009). Every type of merger is impacted by these matters instead of cross-border agreements which may be dominant. A further peril is that cross-border contracts are

entered into merely to gain benefits. To regard the facets of wondering literature there are subjects and anxieties in context of the methods which incorporate cross-border mergers that have been completed.

For cross-border mergers, informative differences are real in the hypothetical model facet as stated by Estrin (2009). In the process of achieving merger benefits, jargon, cultural problems, and official systems are cited as types of primary obstacles. The capabilities to draw attention of skills from other enterprises have been provided to differences useful influence procedures, attainment of communal mergers in firms and the particular speed.

Generally, between the links amongst the merging methods of firms informative differences are the source of distrust, to which the triumph can be impeded by the communication matters. There is no clear theoretical model on the other hand, which is related to the impediments which harm the efficiency; despite it being a hypothetical exemplar. In contrast to domestic mergers, for a successful cross-border merger, however, this proves that the closer the facets, the more the obstacles, and these are limited to specific countries since many of these obstacles are linked to the regulatory and informative systems prevalent there. According to the origin of enterprises in context to the obstacles, there exist behavioral national variations which need to be expected and depend on the country. By being a source of synergy, informative differences can enhance merger ability in addition to generating benefits as opined by Fama (2009). However, impediments can be built by this, for expanded manner of spreading that is more possible. Instead of any of the domestic mergers participating in cross-border mergers as to gain more useful outlooks for the firms a theoretical

exemplar method has been developed by Bjorvatn (2001) for the profit of handling cross-border mergers. By allowing varied mediums of entry in addition to cross-border mergers and for assessing and impacting triumph of cross-border mergers in addition to assessing entry outlays these are the primary variables, he employed to follow Fama (2001). Greenfield investment has been shifted into avenues which are minimally attractive by entry outlays, by methods using cross-border mergers augmented to the degree of revenue. On the other hand, in that market for achieving success as expected facets domestic mergers are regarded to be linked to a rise in the entry expenses. In contrast to the domestic ones in envisaging cross-border mergers success focus on hesitancy which is the outcome in this scenario. While choosing the expected outputs in addition to the entry outlays, the cross-border mergers can also provide access benefits to the distinctive market. In this regard, for both domestic and cross-border mergers, there is present, a theoretical merger literature. In terms of price uncertainty and demand exemplar depending on the matter of the doubt as put forth by Das and Sengupta (2001) both in domestic and cross-border mergers is the correct method.

2. 4. Experiential Study

M&As are expansion strategies that corporates adopt to increase scale and market share rapidly. They are also used to diversify business interests or acquire technological capability, capital, expertise, or enter new markets. From the business perspective, growth is seen in terms of capital, profits, and shareholder value, operations become more efficient, and business registers improved performance. One of the major benefits of M&A

transactions is the decrease in costs as resources are shared and processes are streamlined. There have been many instances of companies taking the M&A route to save costs like Wells Fargo, whose acquisition of First Interstate in 2006 resulted in cost savings of USD 1 Billion (Jensen and Ruback, 2003).

With the restructuring of processes and systems that follow a merger, companies become more efficient and effective as the organization's operational dynamics are realigned and streamlined. The benefits of operating on a large scale, reduction or elimination of wasteful and duplicating processes, the sharing of personnel and other resources all lead to high savings and better performance. The sharing of resources including capital infusion reduces costs and facilitates growth and with open lines of communication, a company can maximize its return on investments. Large-scale operations give companies larger purchasing power and rates for material in bulk can be contracted at far cheaper rates than if supplied to separate companies. M&As deliver value in terms of cost savings, operational efficiencies, large-scale economies, increased market share, diversified product lines, and expertise and technology.

Bradley and colleagues (2008) observed that mergers and acquisitions in allied industries also create effective synergies for companies to cut costs and increase returns. Large-scale operations lead to better economical management which gives companies a better chance to compete in the market as they can deliver value to the customer by providing better products and services at cheaper costs. As mentioned earlier, M&A deals increase customer base and market share leading to increased revenues and

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profits. It also helps eliminate unhealthy competition as the new merged enterprise now strives for dominance instead of competing with each other as they did before the merger like the successful Hindalco-Novelis acquisition.

Acquiring a company is the quickest and most effective way to enter a new market or increase market share and standing in a current area and location of operations. A company can grow at a faster rate and be market ready virtually by Day One whereas in a Greenfield project, a company might have to strive for years to start production and penetrate the market. A merger also effectively deals with competition as shared resources, expertise and technology coupled with the economies of scale make them competitive and help increase market share.

To be considered successful, mergers and acquisitions either register higher revenues or effectively reduce costs. There has been a lot of research indicating that cost saving rates has been higher than increased revenue figures in M&A deals. This is not to say that companies have not grown in terms of revenue. It merely indicates that the rate of growth is not matched by the rate of savings. Operational efficiencies, cost savings, and increased revenue are the three vital objectives of a merger (Jarell and colleagues, 2008).

Andrade and colleagues (2001) have researched and studied the success of mergers and acquisitions in India and whether the stated objectives of the M&A have been met. Between 2005 and 2008, 26 M&A deals were struck with international companies from 13 different countries. Their study

revealed that most mergers did not register high profits or top-line growth. Some companies showed negative rates of return and thus the objective of increasing revenues taking the M&A route was not successful. Similar results have been recorded in the US although 107 mergers that took place in the US in 2000 showed higher valuations and asset increases. Shareholder value and company valuations in India did not increase as substantially as they did in M&A deals that took place in the UK (Anandan and colleagues, 2008).

The main motivational drivers for mergers and acquisitions are market dominance and efficiency whilst growth of shareholder wealth though a prime factor is not impacted as heavily and sometimes falls. Research indicates that valuations are less when larger multinational companies pick up controlling stake.

2. 5. The Indian Merger Environment

This study examines the M&A environment in India and also studies previous research on M&A analysis of firms in Europe. A major portion of this study is devoted to the understanding of mergers and acquisitions in the EU. With the opening up of economies globally and governments announcing policies to attract FDI and amending rules and regulations for foreign companies to do business, a lot of international M&A deals have been witnessed in Europe. A lot of research and information is available on business collaborations in Europe along with the entry of cross-border companies. These studies are detailed and comprehensive accompanied by detailed analysis (Chaudhri, 2002).

A lot of mergers in Europe took place at the turn of the millennium.

Bridgeman (2000) observes that the UK, France, and Germany have been aggressive in conducting M&A deals across the world. International companies have entered their markets with heavy investments and taken over local companies as well but these countries impose restrictions on certain industries and sectors. Luxembourg, for one, however, does not have any restrictions. The European Union Merger Control Act was formulated in September 2000 to assess and evaluate mergers and acquisitions as Europe tried to centralize operations to facilitate transnational transactions. This Act was amended in 2004 and 2008. The objective to bring about uniformity in procedures across Europe for business though noble is contentious as there are many differences between the richer nations and countries not doing as well. There are also policy shifts and business conditions that create issues related to the venture and investors are often forced to rethink their options (Bridgeman). Mani (2005) observes that the nations who are far more economically developed hold the edge in cross-border negotiations.

The European Merger Control Act came into force on 21st September, 2000 and further amendments were carried out in 2004 and 2008, but these were only enacted on 21st December 2009 giving the European Commission more discretionary powers (Anandan and colleagues, 2008). Mergers across borders demand that cultural and social uniqueness and sensitivity have to be factored in and this is controlled by the EC Authority. The amendment in 2008 was to create and empower the EC Authority to be able to function as a single window facilitator and ensure social and economic ends were met and local interests protected through each venture (Rice). The European

Commission Green Paper (2001) has also highlighted the amendments led by the Act but there still are a lot of problems and procedures that are yet to be sorted out by the Act especially those to do with applications and filings.

These gaps and ambiguities create roadblocks in M&A transactions especially when international companies merge with domestic companies to create powerful alliances and companies such as the P&O-Stena and American Airlines-British Airways in the UK which faced problems due to differences in policies (Bridgeman, 2002). The European Commission's success with the single window facilitation for mergers and acquisitions in Europe is still to be proven.

The EC intervention to facilitate and fast-track procedures for mergers in Europe was a noble intention especially the amendments in 2008, which empowered the commission considerably (Basant, 2000). There are about 200 mergers that have benefited from this Act. In fact after the amendments in 2008, mergers increased from 10% to 15%. Thus, the issues before the 2008 Amendments and after need to be studied in conjunction to understand benefits, valuations, and profitability impact on the host nation. Many deals may have been affected adversely or may not have been affected as such due to the expectation of the changes in policy. Deals require clarity, timing, focus, and policy and any variable that could be affected due to ambiguity of policies or lack of trust is bound to affect the merger. The European framework is a structure, which is far more rigid and severe than the US's as illustrated by the GE-Honeywell experience and alliances in aviation. These strictures impact profitability in Europe and investors end up with lower margins.

The Merger Control Act however, remains a structure that any nation can learn from and adapt to suit its own conditions and environment. Mehta and Samant (2007) suggest that this Act could be adapted to suit India in the current business environment. A reduction in companies going in for restructuring or strategic alignments has put pressure on countries with extended and cumbersome policies as companies prefer to shif