

# [Merger and acquisitions of multinational enterprises economics essay](https://assignbuster.com/merger-and-acquisitions-of-multinational-enterprises-economics-essay/)

Growing through M&A is one of the main ways in which MNE’s seek to expand globally. Often, however, expectations outrun reality and the difficulties of merging two companies are underestimated. Examine a cross-border takeover or M&A of your two cases choices discussing the balance between the benefits it has generated and difficulties that had to be overcome.

Introduction:

Globalisation has influenced by major changes in the business world over the past decade. Companies have been searching for competitive advantage in a worldwide scale. Companies are forced to follow their customers- who are going global- as they respond to the competition that is worldwide in scale. Globalisation in combination with other trends such as deregulation, privatisation and corporate restructuring has spurred an unprecedented surge in cross-border merger and acquisition activity. The recent figures in business clearly indicate that cross border mergers and acquisitions have become a fundamental characteristic of the global business landscape.

Within the globalisation context, that has opened up a new world of corporate opportunities, accompanied by increasing risks and challenges, rapid changes and volatility, M and A has been an accelerating phenomenon- a business ‘ mantra’- for companies driven by the urge to survive, evolve and grow. But the big question is whether these business mergers and acquisitions are pulling off as well as expected or intended, through the realizations of goals, there by achieving projected/desired levels of synergy.

## Background of the study:

The mere process of M and A cannot guarantee success. It is only a facilitator and post merger operating performances depend largely on how well post merger opportunities are capitalized and resources are utilized.

In the early ’90s there was a significant awakening in this sector to become more competitive and exploit opportunities on a global playing field through M and A’s and other strategic alliances. As a result of the liberalization measures that lessened governmental control, regulations and trade restrictions, there has been a spurt of M and A activity in the recent past – a manifestation of the corporate response to the greater freedom to modernize , expand and diversify. A liberal economic policy provided the stimulus and favorable atmosphere for companies to upgrade their technological and production capabilities (economies of scale)and improve their cost effectiveness and competency by merging with related or subsidiary units. During this period, M and A’s were also a significant method of foreign investment. The services sector, mainly the financial (including the banking sector) and communications services, leads this trend, with the chemical industry being the leader in the manufacturing sector. M and As are poised to rapidly increase in the near future as they provide acquiring companies the cutting edge amidst global competition. Beena (2004) says that the new industrial policy also brought about a shift in corporate strategies, in terms of share holding patterns, adoption of product differentiation, etc. Studies by Khanna (1998) show that, as a consequence of withdrawing all monopoly restraints in acquisitions, several markets have become oligopolistic and reduced competition. Many of these Mergers and Acquisitions involved companies of the same business groups, aimed at increasing control levels to safeguard against possibilities of takeover.

Merger and Acquisition trends and patterns can be theoretically linked to studies of market power and reactions, access to markets or technologies, managerial ego etc(Cantwell and Santangelo, 2002)

There are many theories on mergers and acquisitions emerging from the studies of international business, industrial organization and financial economics, that include the category on synergy which assumes that the merger creates a total value that is greater than the sum of the values of individual firms where as the hubris theory proposes that value resulting from the merger is zero. Economic theory provides two contrasting perspectives regarding the efficiency and performance of mergers and acquisitions as corporate restructuring strategies- The value maximizing theory which proposes that corporate mergers as value -enhancing activities where managers work for shareholders wealth maximization goal of the firm(Franks and Hariss, 1989) second is the managerial theory which proposes merger activities as an extension of managers own personal interests and wealth maximization prestige of managing a bigger post-merger business entity(Roll, 1986) and as a platform of corporate control where managerial teams compete for the rights to manage resources(Jensen and Ruback, 1983).

Drivers and motives of M and A’s are to gain market power, reducing new product development risks, gaining access to innovative capabilities, maximizing efficiency and reshaping competitive scope.(Hitt et al., 2007) Other reasons include overcoming finance issues, that firms face due to information asymmetry (Fluck and Lynch, 1999)

Kumar(2009) argues that the post-merger profitability, solvency and assets turnover of acquiring companies show no improvement when compared with pre-merger figures, and hence mergers do not usually lead to improvement in the financial performance of the acquirer. The results of his study show that mergers are not aimed at maximizing wealth of owners and suggest that managers should focus on post-merger integration issues to generate synergy rather than achieving bigger corporate size, in the pursuit of hidden agendas.

Beena(2004) emphasizes that one of the main objectives of M and A is to increase equity, which could be further leveraged to borrow resources for modernization and up gradation.

According to Vardhana (2001) the population of all firms, in a finite sample, would change since there would be new entry through merger of an established firm with an incumbent and likewise, the merger of an incumbent would lead to its exit from the industry. This firm restructuring, a process taking place primarily through mergers, makes it difficult to choose a sample of firms that can be analysed with long-run data to isolate the effect of a merger. Therefore the short-run data for a merging firm would be more appropriate, which at the same time is long enough for pre- and post-merger period, so as to capture the merger effects.

One bottleneck in assessing post merger performance is that the target company ceases to exist. Hence, for a more accurate measure of the merger effect, some post merger performance studies have isolated it by adopting the model that compares performance of the merged entity with that of control groups consisting of acquirer and target before merger and matching sample of units that did not involve in merger but have similar size and belong to the same industry.

Also, to isolate the impacts of mergers and acquisitions which are influenced by several factors existing that are dynamic, a better model would have been the regression to norm frame work developed by Mueller (1986), by which analysis of regression of profits and regression of persistence of profits to norm can be carried out comparing to the industry standard as well or the control group. This would help to capture the impacts of M and A’s, with respect to size, pre-deal profitability, size, competition etc. Other variables like Market power/Market share, Inventory turnover, export intensity, capacity utilization, price -cost margin; etc could also have been included in the study.

Kumar(2009) argues that the post-merger profitability, solvency and assets turnover of acquiring companies show no improvement when compared with pre-merger figures, and hence mergers do not usually lead to improvement in the financial performance of the acquirer. Overall, my opinion is that the authors have been rather vague in their conclusion and failed to establish convincingly that mergers and acquisitions have any significant positive impact on corporate performance, to a large extent because of the sample limitations as well as the limitations of financial data and their interpretations. But the research paper contributes to the understanding of M and A’s in India and their relative performances, although in a limited way. It also emphasizes that synergy can be generated in the long run; by optimizing resources and that the success of M and A deals depend on proper deal valuation, futuristic planning and effective management.

Research similar to the one being reviewed has been conducted on mergers and that occurred almost in the same time frame, during the post liberalization period in India. But the results do not corroborate with each other. The term merger has been broadly used beyond its technical implications, to discuss the merging between the acquirer and the target in some acquisition cases too. However I have noticed that the samples of firms or cases of mergers taken for most of these researches were quite different as there were very few companies that were common to all the samples (of studies conducted by different researchers on the topic), within almost the same time frame. This disparity would inevitably yield different results, that cannot be co-measured and only a trend relating to the respective samples or cases can be analysed. The possibility of self-selection bias arising cannot be ruled out, because of the selection of samples comprising ‘ survivor’ firms that are existing during the pre-merger and post merger period under study. Also as pointed out earlier, results obtained using the operating performance approach, can be influenced by the limitations of financial measures to capture the impacts of mergers and acquisitions as a whole , as well as the intrinsic limitations of the financial ratios themselves. Some of these ratios do not have a benchmark to fit all industries, capturing only quantitative factors and not the qualitative factors. Also these ratios might vary and have varying significance across different industry types. This would give a limited perspective of the impacts of mergers and acquisitions. The more number of parameters used, the better the perspective and the conclusion. However this brings up the issue of comparability and co-measurability between results of researches on this topic, unless all studies use the same parameters.

Falkner and Pitkethly (2001) say that there is an increasingly positive approach to mergers and acquisitions than before. Earlier M&A was seen as a false activity but now they are welcomed by the government as well. Cosh and Hughes (1996) are skeptical about the merger activities and talks about the need for government’s regulations over the merger and acquisitions in the light of U. K. economy. They argue that everything should come under legal scrutiny.

Kang and Johanson(2001) talks about the role of globalization in promoting mergers and acquisitions and how mergers and acquisitions help companies to survive in the competitive environment. They see merger and acquisition as a positive business tactic in the competitive world. Ahmed and Glaister(2008) have done an extensive research on the topic and have pointed out the recent trends in CBMA in the U. K. They have identified the various driving forces behind the cross border merger and acquisitions in the companies in UK.

## Benefits:

The driving forces underlying the trend of CBMAs are complex and vary by sector. One of the most significant driving forces is technological change. In addition, changes to government policies influence CBMAs by opening up opportunities and increasing the availability of favourable targets for mergers and acquisitions (M&As). Other forces are market drivers, industry-level drivers and firm-level drivers.

The scale of CBMAs involving UK companies has increased rapidly in recent years. The area analysis shows that European Union (EU) companies are the most significant target for UK companies followed by the USA and Canada. In terms of distribution within sectors, UK companies tend to acquire more manufacturing companies in the EU, the USA and Canada than in the Asia-Pacific region.

In contrast, UK companies tend to acquire more service sector companies in the Asia-Pacific region than in the EU, the USA and Canada.

## Example:

On January 30, 2007, Tata Steel, part of India’s Tata Group, has purchased 100% stake in the Corus Group at 608 p. per share.

Acquisition Type : Indian Company acquiring a foreign company.

Tatas overtake the Mukesh Ambani- Reliance Group to become India’s largest business house by this takeover.

Tata’s, who have staked their century old reputation, will certainly leave no stone unturned in making this acquisition a success.

## Benefits:

Triples Tata Steel’s capacity to almost 28m tonnes from 8. 7 million.

Gives it access to high- value European market.

Corus has highly developed R&D capabilities.

## Dangers:

Tata’s have paid a heavy price.

It now needs to service a very large debt burden

Integration can be a problem in such acquisitions because of both distance and culture

## Challenges ached:

Financials will hinge on the future and the behavior of the steel prices

Muthuraman is confident about more consumption from India and China over the next 50 years

Labor is another issue as British Union, which represents 80% of UK based workers, warned against trimming down the labor force

Post merger integration of human resources would be a Herculean task as acquisition of this scale in a developed country by an Indian company has not been seen before

Cultural integration is another issue- retaining key talent and imbibing confidence in the workforce

The merger may take 5-6 years to realize its full potentials. But these will certainly a trend-setter as to what will happen, not just in the Indian steel industry, but across all sectors.

## Discussion:

The evidence can be found from many sources like journals and articles that point out the recent trends in Cross border merger and acquisitions. A sneak peek into the business world also reveals the relevance and importance of CBMA s in the new global economy. There are many examples that can be analysed to show the recent trends in CBMA s.

An in depth study into the recent trends in CBMA reveal that presently, companies in UK are in the forefront of CBMA s both in the case of value of Mergers and Acquisitions and the numbers. CBMA s occurred between manufacturing companies in the US and EU, while in the Asia pacific region, the service sector companies merged with the UK companies.

These are all evidences for recent trends in cross border merger and acquisitions.

## Conclusion:

Companies are expanding beyond their domestic markets to be a part of the global market place. In doing so, companies can choose to export, establish new operations or acquire existing companies. CBMAs are now a common activity among the companies. UK companies are in the forefront of CBMA s in both the numbers of M&A s and their values. Between 1996 and 2005, UK companies acquired 7, 026 foreign companies. In terms of value, UK companies acquired £520 billion worth of foreign companies over the period. The area wise analysis reveals that EU companies are the most significant target for UK companies followed by the USA and Canada while Asia pacific region also showing an increase in CBMAs. In terms of sector distribution, UK companies tend to acquire more manufacturing companies in EU, USA and Canada and more service sector companies in the Asia pacific region. High technology and Industrials are the most active industrial sector groupings in the EU, USA and Canada while financial sector was the most active industrial sector in the Asia-pacific region. In short, we can say that while UK companies acquired EU and USA technology over the last decade, financial services were also acquired by UK companies in the Asia pacific region.

The driving forces behind CBMAs can be grouped into factors at the macro-economic, market, industry and firm-level as well as technological and government-related factors. Technological change acts both as a pull and push factor; it promotes international expansion by reducing communication and transport costs; it creates new business and markets by rapidly changing market conditions or by increasing the costs of R&D. The speed of technological development along with the technical competence and market knowledge, flexibility and ability to innovate are increasingly promoting the CBMAs. Companies are searching for partners from whom these tangible assets can be obtained. Government policies including liberalization, privatization and regulatory reforms influence CBMA s by opening up opportunities and increasing the availability of favourable M&A targets.

Economic fluctuations like recession or boom can also affect the level of global M&A activity and its regional focus. Growth prospects, market structure and competition in the market promote CBMA. Slow growth, over-capacity and increased competition in global markets typically drive industrial restructuring and often make M&As preferable to Greenfield investments.

This report tried to analyze the recent trends in CBMAs in U. K. To conclude, it can be said that CBMAs by UK companies are increasing by time and more and more companies are becoming aware of the benefits of CBMA. There is a need for a well planned strategy among these companies and that can lead to cost effective CBMA s leading to the benefit of the economy.