



Strategic Flexibility of Indian Corporates – A Study of Market Response to Cross-border acquisitions

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Abstract

In today's highly volatile and competitive business environment, organizations are espoused to have strategic flexibility. Viewed from this perspective, cross-border acquisitions have become a critical constituent of expansion strategies for corporates especially in emerging economies. The aim of the paper is to analyze the share price reaction to the announcement of cross-border acquisitions by firms from emerging economies. To meet these objectives, 110 cross-border acquisitions announced by Indian companies during the period of 2012-2015 constitute the sample of the study. It has been observed that shareholders of the acquiring firm experience statistically significant and positive average abnormal return (AAR) of 0.49% on the day of announcement. Also, cumulative average abnormal returns (CAAR) examined over multiple event windows also point to significant value creation for Indian bidders. Moreover, the gains are more pronounced when the acquired firm is based in developed markets. This research work endeavors to widen the existing understanding on cross-border acquisitions by examining the short-run performance of CBAs by enterprises from emerging markets (like India).

Keywords: Cross-border acquisitions, India, Share price performance, Event study, Emerging markets, Developed markets

Introduction

The liberalization and globalization of financial markets, fierce competition and technological developments have made business organizations vulnerable to volatile, uncertain, chaotic and ambiguous (VUCA) environment (Sushil, 2017). To manage these threats effectively, firms perform are compelled to be flexible and competent with respect to their strategic processes (Hina et al., 2016). Firms have to move away from the clutches of rigidity and create flexible organizations.

As a concept, flexibility may be defined in terms of access to various options, change mechanisms in various processes/strategies and freedom of choice (Sushil, 2017a; 2017b). In today's turbulent and unpredictable environment, maintaining competitive advantage with only one option evidently has become an arduous task for business firms. Thus, organizations from emerging economies are exploring multiple options by venturing into overseas transactions.

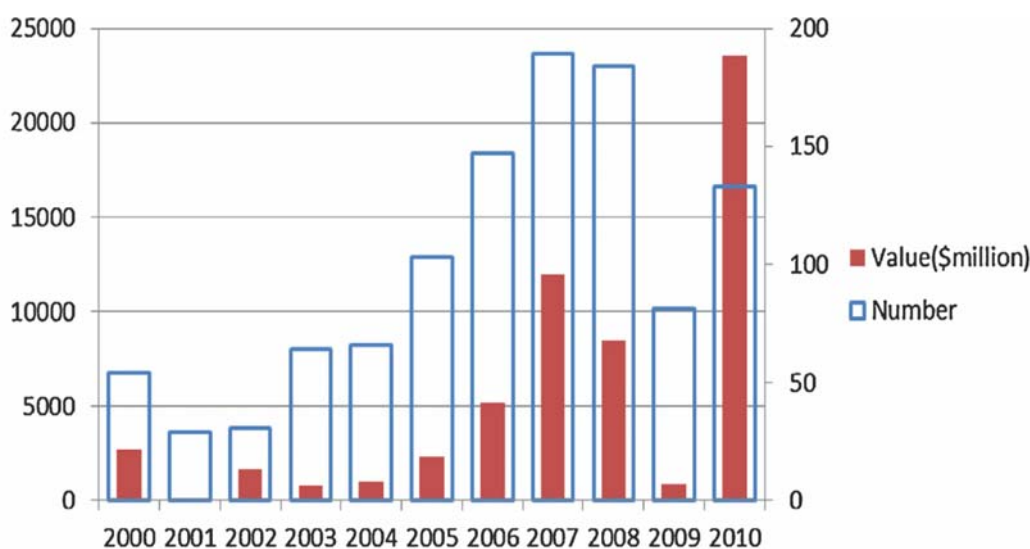
Exhibiting strategic flexibility, MNCs from emerging markets have been rigorously involved in cross-border acquisitions (CBAs) to make their presence felt at the global level. As a result,

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there has been a sharp increase in outward foreign direct investment (FDI) from developing economies. According to the recent UNCTAD World Investment Report, FDI from emerging economies reached a record level of US\$454 billion and accounted for 39 per cent of global FDI outflows; it was only 7 percent 15 years ago (UNCTAD, 2014). Also, there has been an increase of cross-border acquisitions (CBAs) from emerging markets, surging from US\$63 billion to US\$109 billion in one year (UNCTAD, 2014).

Apropos to this, overseas acquisition has developed as an inevitable ingredient of the expansion strategies by Indian firms seeking diversification of operations and quick access to international markets. These strategic decisions improve the geographical and operational flexibility by allowing firms to develop a network of businesses in different parts of the world. Since the 1990s with the liberalization and privatization of Indian economy, Indian companies have been making huge investments in foreign markets to expand their operations across national boundaries.

It is evident from Fig. 1 that the number of cross-border acquisitions completed by Indian firms has shown, by and large, an increasing trend during 2000-2010. The global financial crisis in 2008 caused a sudden plunge in the number of overseas transactions that regained its momentum in 2010. Since 2010, CBAs have shown an upward trend with 40,400 deals amounting to \$ 3.5 trillion being transacted in 2014 (Swaminathan et al., 2014).



Source: Thomson One

Figure 1: Completed Cross-border deals by Indian firms 2000-2010

Hitherto, most of the literature in the area of mergers and acquisitions in all disciplines of management has evolved in developed markets. Filling the void, this academic work seeks to widen the existing knowledge on mergers and acquisitions by examining the short-run share price performance of Indian acquiring firms involved in CBAs. India, being one of the fastest and largest emerging economies, has been taken as the representative country. Moreover, to understand the pattern of value creation, a disaggregated analysis has been conducted on the basis of the status of target country (developed/ emerging).

The rest of the paper has been organized as follows: Section 2 reports the existing studies and their findings. Section 3 describes the methodology and the data used in the study followed by section 4 comprising the empirical results and discussion thereof. Lastly, Section 5 contains the concluding observations.

Literature Review

A substantial amount of academic work has been carried out for analyzing the performance of cross-border acquisitions in virtually all domains of management. But most of the studies have evolved in the context of developed economies; the studies in the context of emerging economies provide mixed evidences on the subject. Put differently, whether such strategic decisions successfully increase the market value of bidders or not, remains unanswered. Some of these studies indicate significant and positive returns to the acquirers' shareholders; while others point to wealth diminution. Also, there is disagreement with respect to the measures used to analyze the performance of cross-border acquisitions. Several scholars have examined synergy gains from cross-border acquisitions in terms of abnormal stock market returns (Duppati and Rao, 2015; Gubbi et al., 2010; Rani et al., 2014a, 2014b, 2015) in the short-run; while a few researchers focus on long-term performance analysis in terms of financial ratios (Narayan and Thenmozhi, 2014). Mittal and Jain (2012) have attempted to use an integrated framework (inclusive of both strategic and financial measures of performance) to assess mergers and acquisitions performance.

The focal point of this study is to analyze the magnitude of value creation/destruction in the process of cross-border acquisitions from the point of view of acquiring companies. Gubbi et al. (2010); Rani et al. (2015) have observed positive abnormal returns (AR) with the minimal probability of being insignificant for the Indian acquirers. Further, they noted returns to be relatively higher when target companies happen to be from developed markets. They cited acquisition of strategic and intangible resources including advanced technology, brands, distribution channels etc., to be the drivers of value creation in CBA. Jain et al. (2017); Rani et al. (2014) and Duppati and Rao (2015) have provided empirical evidence of positive stock market reaction post CBA announcement by Indian companies.

In multiple-country context, Bhagat et al. (2011) have observed significant positive abnormal returns (AR) of 1.09% on the day of CBA announcement by the acquirers from emerging markets while, Aybar and Fici (2009); Narayan and Thenmozhi (2014) have noted considerable deterioration in terms of value in the wealth of shareholders of the acquiring companies from emerging nations.

Few studies (Corhay and Rad, 2000; Uddin and Boateng, 2009; Cakici et al., 1996) have examined value implications of overseas acquisitions for the bidding firms from developed capital markets and reported statistically significant negative returns. Aw and Chatterjee (2004); Conn et al. (2005); Kohli and Mann (2012); Rani et al. (2014) have compared the performance of domestic acquisitions with cross-border acquisitions, and reported mixed results.

Despite voluminous studies on mergers and acquisitions, inquisitiveness of various stakeholders viz., researchers, education intelligentsia, policy-makers and senior executives with regard to share market reaction to the announcement of CBAs by emerging economies largely remains an unexplored field. Hence, the present study is a modest attempt to contribute to the extant literature on mergers and acquisitions.

Methodology

Data collection and sample selection

Cross-border acquisitions announced and completed during 2012-15 by the Indian companies listed on CNX Nifty 500 constitute the sample of the study. The time period of 2011-12 onwards indicated an increasing trend in terms of number of cross-border acquisitions following global financial crisis of 2008. Hence, the research period has been taken from 2012-15. Further, preliminary data pertaining to the overseas acquisitions by Indian companies have been sourced from Bloomberg database, a financial database having global coverage. For each deal, the database lists the announcement and completion date, name of the acquirer and the target company, the target country and other deal specific information. Further, the announcement dates have also been manually verified from the corporate announcements on Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). The process of sample selection includes the following steps:

Firstly, to satisfy one of the assumptions of the event study methodology, event window around each announcement date has been scrutinized to control for any confounding effect (McWilliams and Siegel, 1997) including announcement of financial results and declaration of dividend. Then, adjusted closing price data on daily basis for acquiring companies as well as CNX Nifty 500 index has been taken from Bloomberg. Stock must have been traded for at least 180 days before and 10 days after the event to form a valid sample. This process has yielded a final sample of 110 CBAs with an Indian company as the bidder. Based on SIC codes, acquiring firms have been grouped into various industries as shown in Table 1. Out of total sample of 110 cross-border acquisitions, 82 transactions involved target firms located in developed markets while 28 deals involved target companies from emerging economies. The target country has been bifurcated into developed or emerging market depending on its current membership status in the Organization for Economic Co-operation and Development (OECD) (Gubbi et al., 2010). Table 2 shows the geographic distribution of CBAs embarked upon by Indian companies during 2012-2015.

Table 1: Industrial classification of the acquirers

Industry	No. of CBAs
Mining	8
Manufacturing	58
Transportation, Communications, Electric, Gas, and Sanitary Services	6
Wholesale Trade	1
Services	37
Total	110

Source: Compiled by the author

Table 2: Geographic distribution of the sample

Target Country	Status	No. of CBAs executed	Target Country	Status	No. of CBAs executed
Azerbaijan	Emerging	1	Luxembourg	Developed	1
Australia	Developed	3	Malaysia	Emerging	2
Brazil	Emerging	1	Mozambique	Emerging	1
Bahamas	Developed	1	Oman	Emerging	1
Canada	Developed	2	Philippines	Emerging	1
Chile	Developed	1	Mexico	Developed	1
Cameroon	Emerging	1	Netherlands	Developed	1
China	Emerging	1	Sweden	Developed	3
Cyprus	Developed	1	Switzerland	Developed	1
Croatia	Emerging	1	Turkey	Developed	1
Denmark	Developed	1	U.K.	Developed	5
El Salvador	Emerging	1	U.S.	Developed	38
Ethiopia	Emerging	1	Russia	Emerging	2
Finland	Developed	1	Singapore	Emerging	5
France	Developed	4	South Africa	Emerging	5
Germany	Developed	12	U.A.E.	Emerging	1
Italy	Developed	3	Uganda	Emerging	1
Liberia	Emerging	1	Vietnam	Emerging	1
Japan	Developed	2	Total		110

Source: Compiled by the author

Methodology

The event study methodology has been applied to measure the valuation impact of CBA announcement on the acquiring firms. Mackinlay (1997) stated in his work that the impact of any unexpected corporate event on the valuation of the firm can be quantified by observing changes in its equity price over a relatively short period of time. CBA announcement is the event of interest in this case.

The day respective stock exchange is formally apprised of the board of directors' approval of the acquisition transaction has been taken as the announcement date. The expected/normal returns have been computed using the estimation period of 150 (-180,-31) days prior to the acquisition event. Abnormal returns are observed over multiple event windows (-1,+1),(-3,+3),(-5,+5) to nullify the element of inefficiency in emerging countries like India; this enables to have more robust results by controlling for leakages, if any.

Stock prices respond to various factors at firm, industry and macro level. Event study is concerned with how much movement in stock price is brought by the event under study. As such, all event windows have been manually cleaned for any confounding events or contamination of information

from various sources including company website, archives of corporate announcements of the Bombay stock exchange (BSE), newspapers, corporate magazines and news portals. The abnormal return on any security 'i' at point 't' (AR_{it}) is obtained by deducting the normal return $E(R_{it})$ from the actual return (R_{it}), earned during the event window

$$AR_{it} = R_{it} - E(R_{it}) \quad (1)$$

Expected/normal returns for sample Indian firms engaged in CBA have been computed using standard market model as suggested by Fama (1976) and employed by Brown and Warner (1980; 1985); Kothari and Warner (2004); Kashiramka and Rao (2014) and Jain et al. (2017). The market model describes the relationship between security's return and the return of market index in the following manner:

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it}, \text{ where } t = -180 \dots -31 \quad (2)$$

In the above equation, α_i & β_i are the parameters indicating the constant term and market beta of the 'ith' stock respectively. R_{mt} is the return on market index where the securities are listed (Nifty 500). ε_{it} is an error term.

The parameters are estimated by regressing security return on the market return using time-series data from the estimation period that excludes and precedes the event window. The estimated parameters are then used in the calculation of abnormal returns during the event window. The daily excess return of firm i for the day t (AR_{it}) is estimated from actual returns during the event period and the estimated coefficients from the estimation period:

$$AR_{it} = R_{it} - (\hat{\alpha}_i + \hat{\beta}_i R_{mt}), \text{ where } t = -5 \dots +5 \quad (3)$$

The average abnormal return (AAR_t) for each day in the event window is calculated as per equation 4:

$$AAR_t = \frac{1}{N} \sum_{i=1}^N AR_{it} \text{ where } N \text{ is the number of acquisition events} \quad (4)$$

The cumulative abnormal returns (CARs) are daily abnormal returns cumulated over part of the event period. Over an interval of two or more trading days beginning with day T_1 and ending with day T_2 , the cumulative average abnormal return (CAAR) is:

$$CAAR_{t1,t2} = \sum_{t1}^{t2} AAR_t \quad (5)$$

This paper tests the following two null hypotheses:

H_{01} : The average abnormal return (AAR) on the CBAs announcement is zero.

H_{02} : The cumulative average abnormal return (CAAR) on the CBAs announcement is zero.

Statistical significance of abnormal returns can be assessed using both parametric and non-parametric tests. To ensure that findings are not induced by outliers, the present work uses a combination of one parametric cross-sectional t-test and one non-parametric generalized sign test.

Results and Discussion

Tables 3 and 4 illustrate the abnormal returns for the shareholders of the Indian companies bidding for overseas organizations. Table 3 reports the average abnormal returns (AAR) on the announcement day in addition to the ratio of positive and negative average abnormal return; while cumulative average abnormal returns (CAAR) along with the number of positive and negative

cumulative abnormal returns have been summarized in Table 4. Moreover, the results of parametric and non-parametric tests performed to ensure the robustness of returns have also been presented in Tables 3 and 4.

Table 3: Overall average abnormal returns to acquirers over 11 days (-5, +5) event window

Days	AR (%)	t-test	Pos:Neg AR	Generalized Sign Z
-5	0.29	1.4164	51:59	-0.1744
-4	0.13	0.8424	53:57	0.2075
-3	0.04	0.2178	52:58	0.0166
-2	-0.09	-0.5153	45:65	-1.3204
-1	0.13	0.7449	58:52	1.1625
0	0.49	2.0862**	64:46	2.3085**
1	0.34	1.3236	60:50	1.5445
2	-0.17	-0.7937	48:62	-0.7474
3	-0.35	-1.7386	42:68	-1.8934
4	0.40	1.3841	55:55	0.5895
5	0.24	1.26	63:47	2.1175

***, ** and * indicate significance at 1%, 5% and 10%

Table 3 enumerates that shareholders earn positive abnormal returns of 0.49% on the day of announcement of cross-border acquisitions; the results come out to be significant at 5%. Nearly 60% of the total deals exert statistically significant and positive effect on the value of the bidding firms. Besides, the acquirer shareholders also experience positive cumulative abnormal returns over different event windows (-1, +1), (-3, +3) and (-5, +5). The returns are significant at 5% for 3 (-1, +1) days and 11 (-5, +5) days event period. The findings are in concurrence with the results observed by Gubbi et al. (2010); Bhagat et al. (2011) and Rani et al. (2015).

Figures 2 and 3 demonstrate the pattern of average abnormal returns and cumulative abnormal returns observed during 11 days (-5, +5) event window. As depicted in the graph, abnormal returns begin to show an increasing trend from two days before to two days after the focal event; yielding highest return on the day of announcement of cross-border acquisition.

Table 4: Cumulative average abnormal returns for acquiring firms over different event windows

Event Window	CAAR (%)	t-test	Pos:Neg CAR	Generalized Sign Z
(-1, 1)	0.97	2.4452**	66:44	2.6905**
(-3, 3)	0.39	0.7305	52:58	0.0166
(-5, 5)	1.46	2.0144**	63:47	2.1175**

***, ** and . indicate significance at 1%, 5% and 10%

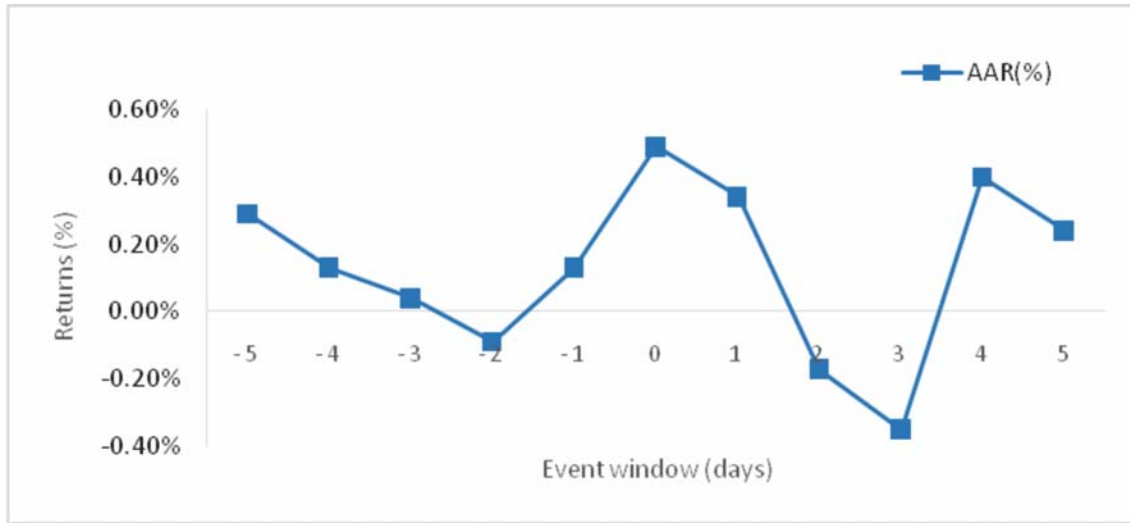


Figure 2: AAR of cross-border acquisitions over 11(-5, +5) days event window

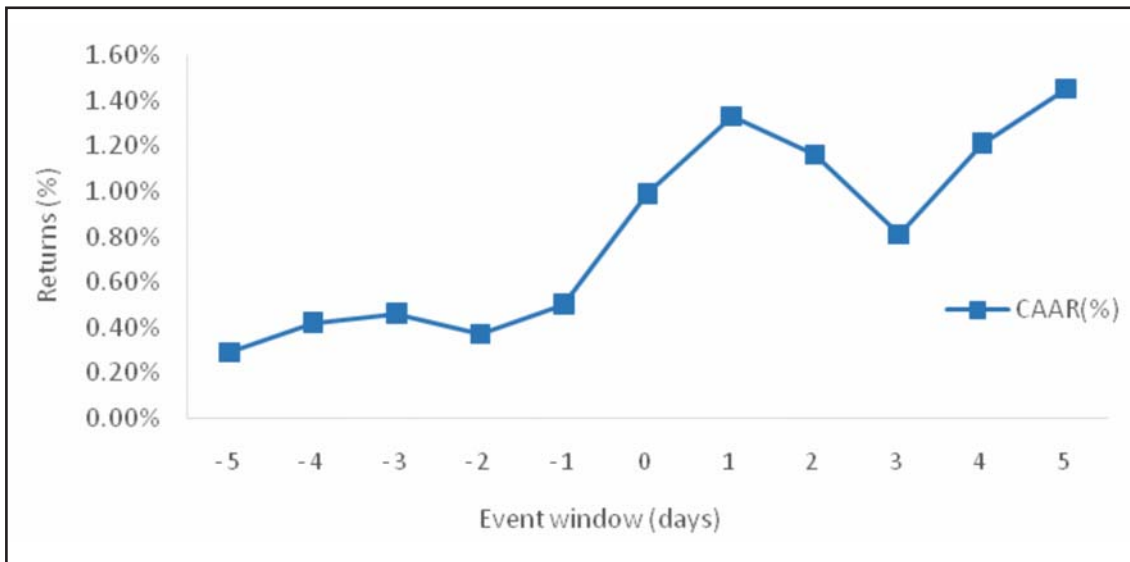


Figure 3: CAAR of cross-border acquisitions over 11(-5, +5) days event window

The impact of the development status (developed/emerging) of the acquired firm's country on the value of the acquiring firm has been compared in Table 5. Empirical findings indicate that bidding for a target firm located in developed markets vis-à-vis emerging economies yields higher and statistically significant returns of 1.29% and 1.63% over 3 days (-1, +1) and 5 days (-5, +5) event window. Equally revealing to note is that acquisition of a target firm based in emerging economies also provides positive albeit not statistically significant returns to the bidders during distinct event windows. These findings are similar to the results reported by Rani et al. (2015).

Table 5: Impact of the status of target firm on CAAR for acquirers over multiple event windows

Event Window	CAR (%)		t-test		pos: neg		Generalized Sign Z	
	Developed	Emerging	Developed	Emerging	Developed	Emerging	Developed	Emerging
(-1, 1)	1.29	0.01	2.6016***	0.0175	51:31	15:13	2.8276***	0.4965
(-3, 3)	0.47	0.17	0.6859	0.2461	38:44	14:14	-0.0502	0.1185
(-5, 5)	1.63	0.95	1.8085*	0.8878	46:36	17:11	1.7208*	1.2526

***, ** and * indicate significance at 1%, 5% and 10%

Concluding Observations

The existing volatile and chaotic business environment have pushed firms to be more flexible with respect to their strategic management process. With this in mind, the present study has evaluated the impact of strategic transition from organic approach to inorganic mode of expansion across national boundaries. Firms from growing economies have increasingly been using cross-border acquisitions to gain competitive advantage and establish their foothold in the world economy. Moreover, such firms, as against acquirers from developed markets, are motivated by the desire to seek strategic resources rather than exploiting their existing resources and own proprietary knowledge & capabilities.

This academic work measures the market response in terms of share price reaction to the announcement of CBAs by Indian firms. Accordingly, the study attempts to find out whether such acquisitions enhance or destroy the wealth of the bidding firm shareholders. In addition, it has examined if the status of the target country has any significant impact on the returns of the acquirers. In other words, whether acquiring a target firm located in developed market generates more wealth for the acquirers vis-a-vis the target firm based in emerging country.

The short-run share price performance of 110 CBAs announced and completed by Indian companies during 2012-2015 has been assessed. The event study methodology has been employed to evaluate the movement in stock price as a consequence to the announcement of CBAs. The empirical findings suggest that announcement of CBAs has positive wealth effects for the shareholders of the acquiring firms; acquirers experience non-negative and statistically significant abnormal returns on the announcement day as well as significant and positive cumulative returns have been observed over multiple event windows. Furthermore, returns are higher for acquisition of targets in advanced market in comparison to emerging economies.

Cross-border acquisitions are more likely to generate synergy gains resulting from economies of scale and scope. Scale economies improve the operational efficiency and flexibility of the firm, creating more benefits for the combined firm. In addition, decreasing of risk through geographical diversification, tax benefits, currency differentials could be the possible antecedents of value creation for the bidding firms.

Emerging market players, more often, venture into cross-border acquisitions with a desire to build and improve their competitive advantage and seek strategic and knowledge based resources. Such strategic skills and capabilities including technical know-how, superior management skills, innovative attitude, advance technology, established distribution channels and natural resources are ingrained in the people, national and organisational culture and community of the host nation.

Ghemawat (2001) has opined that the quality of assets available in a country is directly proportional to the level of economic development of that country. Hence, acquiring a firm located in advanced

economies generates higher value for the bidders' shareholders. Furthermore, developed markets are characterized by stringent investor protection laws (Bhagat et al., 2011), higher governance standards (Martynova and Renneboog, 2008; Khanna and Palepu, 2004), low levels of corruption and higher institutional development; encouraging acquirers to bootstrap themselves to higher standards, thus producing positive wealth effects for the shareholders.

The study is expected to provide invaluable insights to the management of firms from emerging economies in general and Indian firms in particular in the context of their overseas expansion strategies. Moreover, it can also have implications for the government and policy makers of emerging economies while drafting regulations for outward foreign direct investments.

The study is restricted to the analysis of overseas transactions by Indian companies only. Moreover, the focus of the paper is limited to the returns accruing to the acquiring firms only. This academic work can be extended to a larger number of emerging economies to throw more light on the pattern of risks and returns involved for the acquirer as well as the target firm.

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