THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

The Factors That Affect the Acquirers' Decisions in India an Analysis through Case Studies

Maria Evelyn Jucunda. M
Research Associate, VIT Business School, VIT University, Chennai, India
Dr. Sharon Sophia
Professor, VIT Business School, VIT University, Chennai, India

Abstract:
Acquisition is one of the very important corporate investment decisions that an acquirer has to make. The consequences of this decision are reflected in the stock returns when an acquirer announces its decision to the market. This study analyses the factors that motivate the acquirers to go in for an acquisition and how the market reacts to the acquisition decision of the acquirers through case study analyses. Four different types of acquisitions are chosen and the factors that affect acquisitions and the acquirers' announcement returns is analysed. The analyses suggest the common motives for acquirers to go in for an acquisition are expansion and market penetration.

Keywords: *Acquisition, announcement returns, acquirer decisions, hostile, friendly, cross-border acquisitions, domestic acquisitions.*

1. Introduction

Acquiring a firm is the most important corporate investment decision a company takes. Literature shows that acquisition is most risky for acquirers and an investment in the wrong target may destroy value for acquirers around acquisition announcement (Fuller, Netter & Stegemoller, 2011). Acquisitions are generally value destructive for acquirers and it is compensated by positive target returns (Barai & Mohanty, 2012). Thus it is significant for an acquirer to invest in the right target create value from an acquisition. An acquisition decision of investing in a particular target by an acquirer is motivated by several factors. Factors that motivate the acquirers may be financial and non-financial. Early researchers attempted to analyse the motivating factors of acquirers and how the stock market perceives these acquisitions to be. Table 1 shows the various theories on acquirer motives and how they affect the stock returns of acquirers on announcement.

Theory	Author	What Does It Say??
Efficiency Theory	NA	M&A are planned and executed to achieve synergies.
Monopoly Theory	NA	M&A are planned and executed to achieve market power.
Valuation Theory	NA	Acquirers achieve net gains through private information.
Empire building Theory	Ambrose & Meggison (1992)	Managers perform M&A for their own benefit.
Process Theory	NA	Mergers as a process outcome.
Economic disturbance theory	Gort (1969)	Merger as a macro-economic phenomenon.
Hubris Theory	Roll (1986)	M&A happens because of the over-bearing presumptions of managers.
Theory of agency costs	Jenson (1988)	Managers are agents of shareholders and because both parties are self-interested, there are serious conflicts between them over the choice of best corporate strategy.

Table 1: Early theories on acquirer motives, Source: Compiled by the author

This study analyses the factors that makes a firm to go in for an acquisition of a specific target and how these factors are perceived in the stock market during acquisition announcement. The four cases discussed in the study are:

- Takeover of JB Chemicals by Dr. Reddy's Lab in 2011 – Failed acquisition
- Takeover of Raasi Cements by India Cements in 1999 –Domestic Hostile acquisition
- The Arcelor Mittal takeover in 2006 – Cross-border hostile acquisition
- Tata Corus acquisition in 2011 – Friendly takeover

The reasons for choosing these takeovers are that they differ in type and so the different causes in each type of acquisition and their market reaction can be effectively captured. Thus the objective of this study is:

- To analyse the factors that lead an acquirer to go in for an acquisition.
- To examine the stock market reaction of acquirers on announcement in each type of acquisition.

2. Case Study Analysis

2.1. Characteristics of the acquisition deal

The characteristics of the acquisition deals analysed is provided in table 2.

Acquirer	Target	Year	Type	Value
Dr. Reddy's Lab	JB Chemicals	2011	Friendly, Domestic	157 crores
India Cements	Raasi Cements	1999	Hostile, Domestic	Acquisition of shares.
Mittal Steel	Arcelor	2006	Hostile, Cross-border acquisition	$ 33.6 billion
Tata Steel	Corus	2011	Friendly, Cross-border acquisition	12 billion

Table 2: Characteristics of the deal, Source: Compiled by the author

The acquisition deals are of different types such as friendly or hostile. A friendly deal is where both the parties such as an acquirer and target mutually agree for the acquisition deal while a hostile acquisition is where the acquirer acquires the target firm without its' consent.

2.2. Acquisition strategy, reasons to acquire and stock market reaction

The strategy of acquirers' to acquire the target, the reasons to acquire and how the market perceived the acquisitions is discussed in this section.

Acquirer	Acquisition strategy	Reasons to acquire	Market Reaction
Dr. Reddy's Lab	Acquires pharmaceutical companies in the same business line across various countries to stabilize its revenue, acquisitions of technology, brands, R&D and expansion. This was a friendly acquisition.	Expansion, Market entry, Vertical integration. Dr. Reddy's wanted to expand its' market in Russia.	Shares in Dr. Reddy's, valued at $5.1 billion, closed 0.11 percent down ahead of the announcement, while JB Chemicals, valued at $128.3 million, closed down 5.39 percent in a weak Mumbai market on Sep 26, 2011 on calling off the deal.
India Cements Ltd (ICL)	Acquired 18% of Raasi's stock from a member of the feuding family that runs the company. Then made a public offer to acquire another 20% (according to the new rules then). The offer price was startling at Rs.300 per share ($7.2), a premium of 72% to the market price.	ICL had huge amount of unpaid loans, The addition of Raasi's 2 mtpa capacity would make it the undisputed leader in the south of the country. Also Raasi's takeover meant automatically acquiring 39.5% equity in the 1 mtpa sri vishnu's cement	Raasi scrip which hovered till Rs. 50 until 1997, tripled in value to Rs.150 in January 1998.

		ltd (SVCL), another group company.	
Mittal Steel	Has done several CBA. Arcelor relented Mittal's offer in the beginning. Mittal made an open offer. Even European govt and the shareholders of Arcelor were against it. But Mittal expected it. Arcelor had already planned to acquire Russia's Sevestrol nad thus brought it as a white knight. Also he trusted that shareholders and politicians will be against Mittal till the end. Mittal tackled the politicians by producing a credible industry plan. Connecting through the senior VP of arcelor, he isolated the CEO Guy Dolle. Sweetened the offer for shareholders by raising the bid and limit shareholding to 43% for five years.	To become a monopolistic market leader, expansion and growth.	Raised up.
Tata Steel Ltd	This acquisition is a friendly acquisition and thus they took their time. Tata and Corus had various similarities among them in business.	To compete with the global steel market and did not want to be left out of the competition.	Tata wining the bid made it's scrip in BSE to fall to 10.7% the next day. The market felt that Tata had paid too much for the deal.

Table 3: Acquisition strategy, Reasons and Market reaction, Source: Compiled by the author

As seen from the analyses, the common reasons for acquirers to go in for an acquisition are expansion and market growth. It can also be observed that the market reacts in a positive way if it feels that the acquirers' decision is correct.

2.3 Acquirer performance:

The acquirers' operational and market performance before and after acquisition is discussed in this section.This section analyses the financial performance of the two acquirers for whom the market reacted negatively at the announcement.

2.3.1 Dr. Reddy's Lab:

As from the analysis it can be seen that the market was happy about the announced acquisition of JB Chemicals by Dr. Reddy's lab but was saddened at the news that the deal was called off.

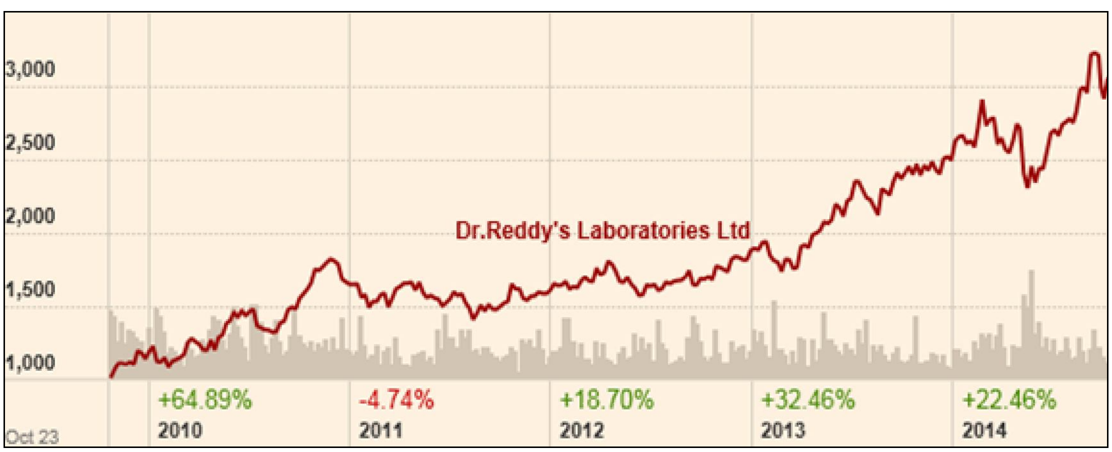

Figure 1: the market performance of Dr. Reddy's Lab in the last five years, Source: FT.com

The chart 5 shows that Dr. Reddy's lab is doing exceptionally after calling off its' acquisition with JB Chemicals. The year 2011 where the acquisition was announced and called off shows a negative trend in market performance relating to the sadness of shareholders because of the called-off deal.

Consolidated Revenues	EBITDA (Earnings before Interest Tax Deprn and Amor.)	PAT (Profit After Tax)	Net Income
Increased by 30%	Increased by 55%	Increased by 45%	Increased by 29%

Table 4: The financial performance of Dr. Reddy's Lab for 2011- 2012
Source: http://www.drreddys.com/investors/pdf/annualreport2012.pdf

The table4 shows the operational performance of Dr. Reddy's Lab one year after acquisition. The firm has shown to do exceptionally well similar to its market performance.

<u>2.3.2 Tata Steel Ltd:</u>
From the analyses of Tata Steel Ltd, it was seen that the market was unhappy about the acquisition. But Tata Steel Ltd had hopes that though the acquisition was not profitable in the short-term, it'll be good from the long-term perspective.

Figure 2: Market Performance of Tata Steel Ltd for the past 5 years, Source: FT.com

The year of acquisition, 2011 shows a drastic downward market performance. The market performance for the years after acquisition hasn't shown any great improvements.

ROA	ROE	Operating Margin
3.77%	8.77%	3.12%

Table 5: The operational performance of Tata Steel Ltd for 2013-2014.Source: FT.com

3. Discussions and Conclusion

From the case studies, it can be seen that the common motives for acquirers to go in for an acquisition are expansion, market entry and growth. It can also be seen that stock market does not always react in a negative way to acquirers. The stock market reaction of acquirers has found to be strongly related to the acquirers' performance after acquisition. Thus this case study analyses provides the acquisition strategy of acquirers and the consequences of their acquiring decisions when the go against the market. From the analyses, the application of theories such as monopolistic market theory, empire building theory and hubris theory was seen. The Tata Corus acquisition stands as a good example of hubris theory which states that the acquirers' always go by their presumptions and that when there are no total gains from an acquisition, the presumptions of the acquirers' are not correct. Likewise Arcelor Mittal acquisition stands as an example of monopolistic market theory and the attempted acquisition of Dr. Reddy's Lab stands as an example of empire building theory.

4. References

1. Fuller, K; Netter, J & Stegemoller, M (2002), "What do returns of acquiring firms tell us? Evidence from firms that make many acquisitions". The Journal of Finance, Vol.57, Issue.4, 1763-1793.
2. Jensen, M C (1988), "Agency cost of free cash flow, corporate finance and market for corporate takeovers", American Economic Review, Vol.76, 323-329
3. Ambrose, B W & Meggison, W L (1992), "The Role of Asset Structure, Ownership Structure, and Takeover Defenses in Determining Acquisition Likelihood", Journal of Financial and Quantitative Analysis, Vol.27, Issue: 4, 575-589
4. Roll, R (1986), "The Hubris Hypothesis of Corporate Takeovers", The Journal Of Business, Vol.59, 197-216.
5. Gort, M (1969), "An Economic Disturbance Theory of Mergers", Quarterly Journal of Finance, Vol.83, Issue: 4, 624 – 642.
6. Barai, P & Mohanty, P (2012), "Predicting Acquisitions in India", Vikalpa, Vol.37, Issue:3.
7. Business Line