The History & Mystery of Worldwide Merger Waves

The Stature in Context to Liberalisation.

AUTHORS

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ABSTRACT

It is well known fact that merger waves exist. These normally come in waves and are an enduring mystery. The search for a single explanation for their existence, growth and size continues. The history of US, UK and India merger waves shows that each wave has had a different motivator, including regulatory and economic factors. The nature of the waves also changed with differences in the type of deals, the behaviour of the involved companies and the methods of payment. Why then should there be a single explanation for the existence of merger waves? Considering their history there is no reason to believe that a single model exists to explain this phenomenon. But, it is crystal clear from the study that they tend to occur during economic expansions, and end when the market and the economy slow down.

1. INTRODUCTION

The corporate world today is witnessing a sudden surge of mergers and acquisitions sweeping across all the industries, which has totally restructured the market place. Mergers and Acquisitions (M&As) have been a prominent trend in the advanced capitalist countries since the late 19th century. But, it has become a regular phenomenon in 'developing' countries recently only.

The total number of M&As worldwide increased almost four-fold during 1990 to 2001. This trend is different from earlier scenario wherein the M&As was looked upon as a threat and had evoked images of dark shadows and backdoor entries to the corporate world. However at present, it has assumed an international dimension due to global economic integration and dismantling of barriers to trade and investment. Back to home, M&As is not new in the Indian Economy. In the past, companies also have used merger and acquisition strategies to grow. Having spread their wings haphazardly during the days of controlled regime, Indian corporate houses are now refocusing on the lines of core competence, market share, and global competitiveness. This process of refocusing has been accelerated by the arrival of foreign competitors.

Naturally, M&As is one of the most effective methods of corporate restructuring and has, therefore, become an integral part of the long-term business strategy of corporate enterprises. Under this milieu, the present study attempts to investigate motivations and trends of mergers and acquisitions all over the world with special reference to India.

2. CONCEPTS & DEFINITION

Mergers or amalgamation, result in the combination of two or more

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companies into one, wherein the merging entities lose their identities. No fresh investment is made through this process. However, an exchange of shares takes place between the entities involved in such a process. Generally, the company that survives is the buyer, which retains its identity, and the seller company is extinguished.

An acquisition, on the other hand, is aimed at gaining a controlling interest in the share capital of acquired company. It can be enforced through an agreement with the persons holding a majority interest in the company's management or through purchasing shares in the open market or purchasing new shares by private treaty or by making a take-over offer to the general body of shareholders.

A takeover, which is essentially an acquisition, differs from a merger in its approach to business combinations. In the process of takeover, the acquiring company decides the maximum price that is to be offered to the acquired firm and hence takes lesser time in completing a transaction than in mergers, provided the top management of the acquired company is co-operative.

Based on the objective profile of an offer, business combinations such as mergers, acquisitions or takeovers could be categorized as vertical, horizontal, circular or conglomerate mergers.

a) Vertical Combination

A vertical combination is one in which a company takes over or seeks a merger with another company in order to ensure backward integration or assimilation of the sources of supply or forward integration towards market outlets.

b) Horizontal Combination

A horizontal combination is a merger of two competing firms belonging to the same industry that are at the same stage of the industrial process. These mergers are carried out to obtain economies of scale in production by eliminating duplication of facilities and operations and broadening the product line, reducing investment in working capital, eliminating competition through product concentration, reducing advertising costs, increasing market segments and exercising better control over the market.

c) Circular Combination

In a circular combination, companies producing distinct products in the same industry seek amalgamation to share common distribution and research facilities in order to obtain economies by eliminating costs of duplication and promoting market enlargement. The acquiring company obtains benefits in the form of economies of resource sharing and diversification.

d) Conglomerate Combination

A conglomerate combination is the amalgamation of two companies engaged in unrelated industries. It enhances the overall stability of the acquirer company and improves the balance in the company's total portfolio of diverse products and production processes.

3. MERGER WAVES IN THE DEVELOPED COUNTRIES

A series of merger movements has been witnessed in many of the market-oriented economies in the past. All these had occurred when the economy experienced sustained high growth rates and coincided with particular developments in business environments.

These are often known as merger waves.

I. MERGER WAVES IN UNITED STATES

Historians refer to five waves of mergers in the U.S. starting in the 1890s. The starting date and duration of each of these waves are not specific, although the ending dates for those that ended in wars or in panics, crashes or other financial disasters are somewhat more definite.

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a) The First Merger Wave (Horizontal Mergers) during 1897 –1904

The turn of the century was a period of rapid economic expansion in the US economy. The first merger wave during 1897 to 1904 was characterized by Horizontal Mergers, which increased concentration in a number of industries. This merger period is known for its role in creating large monopolies. The main motivational factors attributed to the first merger movement are:

- Obtaining economies of scale
- Merging for monopoly, and
- Promotion of failing firms

b) The Second Merger Wave (vertical Mergers) during 1922-1929

The second period of business combination activity, fostered by the federal government during World War I, continued through the 1920s. Like the first one, the second merger wave also began with upturn in the business activity in 1922 and ended with the onset of a severe economic slowdown in 1929.

c) The Third Merger Wave (Conglomerate Combination) during 1963-1970

The diversification of conglomerate types dominated the merger movement during the sixties. During this period, there are many new government regulations being framed to control the merger spree from affecting the economy adversely. Just like MRTP Act in India, the amendments in Clayton Act of 1914 by the Cellar-Kefauver Act of 1950 undermined the importance of horizontal and vertical mergers and conglomerate mergers reined the corporate restructuring. When the merger activity peaked in 1968-70, horizontal and vertical mergers accounted for only 17 percent of the total number of mergers and rest are conglomerate.

d) The Fourth Merger Wave during 1981-1989

This period was featured several unique and interesting features. Firstly, it was a period of mega-mergers. Some of the largest firms in the world (Fortune 500 firms) became the target of acquirers.

Secondly, Investment bankers played an aggressive role in M&As activities by providing specialized advisory services to the concerned firms. Thirdly, the concept of using debts to finance acquisitions (Leveraged Buy Out) was emerged during this period. Moreover this merger wave also featured innovations in acquisition techniques and investment vehicles. The investment bank, Drexel Burnham Lambert pioneered the growth of the junk bond market.

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e) The Fifth Merger Wave (Mega merger) of 1992 Onwards

The Fifth merger wave began in approximately 1993 when the economy began to recover from the 1990-1991 recession. As the economy expanded, firms sought to meet the growing demand in the economy by acquiring or merging with other companies. One thing that is unusual about the Fifth merger wave is that it somewhat closely followed the Fourth merger wave, which began in approximately 1984 and ended in 1989.

The 1990s featured the most intense period of mergers and acquisitions in U.S's economic history, which is recognized as the fifth merger wave. This wave featured many record-breaking mergers.

II. MERGER WAVES IN UK

Merger waves in the UK have a far shorter history than those occurring in the US. Nothing akin to a substantial merger wave transpired before the 1960s although there was a small wave in the 1920s that was inspired by the widespread introduction of mass production technologies in the UK following the end of the First World War.

The first real merger wave in the UK was in the 1960s and coincided with the internationalization of the World economy. The British government decided that large firms were needed to compete effectively on the international stage and to achieve this goal the Industrial Reorganization Corporation (IRC) was created with a brief to encourage the development of such companies through horizontal mergers which made up the majority of mergers in this wave. Amongst the top 200 manufacturing companies in 1964, 39 (19.5%) were involved in merger or acquisition activity within the next five years.

In the UK, horizontal mergers were the dominant form between 1954 and 1965 and since then there has been a trend towards diversified merger. The value of assets acquired through diversified merger rose to 33 percent in 1972 from 5 percent in 1966. The merger wave since 1980s witnessed divestments on a large scale. In 1992 it was accounted for 31 percent of all acquisitions and mergers.

4. THE INDIAN EXPERIENCE

Though mergers between large business firms have been negotiated and concluded right through the post-independence period, M&As is not new in the Indian economy. In the past also, companies have used merger and acquisition strategies to grow. Having read their wings haphazardly during the days of controlled regime, Indian corporate houses are now refocusing on the lines of core competence, market share, and global competitiveness. This process of refocusing has been hastened by the arrival of foreign competitors. Naturally, this requires companies to grow and expand in businesses that they understand well. Thus, leading corporate houses have undertaken restructuring exercises.

M&As is one of the most effective methods of corporate restructuring and has, therefore, become an integral part of the long-term business strategy of corporate enterprises. Since 1991, the process of liberalization, privatization and globalisation initiated by the Government of India has influenced the functioning and governance of Indian companies, which has forced Indian companies to refocusing their strategies.

In the process of refocusing, mergers and acquisitions are becoming a normal phenomenon.

a) Stature of the Corporate Control Market in India before Liberalization

Although prior to 1991, mergers and acquisitions were restricted under Indian law, in terms of industrial licensing laws and restrictive statutory provisions, Takeovers, Mergers and Acquisitions were not unknown.

In fact, Swaraj Paul and Sethia groups attempted raids on Escorts Ltd. and DCM Ltd., but did not succeed. The Hinduja raided and took over Ashok Leyland and Ennore Foundies and secured strategic interests in IDL Chemicals and Astra IDL. The Chhabaria group acquired stake in Shaw Waalace, Dunlop and Falcon Tyres.Prominent industrial group in the country have also been active in takeover bids. For example, the Oberoi group has taken over Pleasant Hotels of Rane Group. Mahindra and Mahindra has taken over Allwyn Nissan; the Jindal Group has acquired Shalimar Paints. History was created by Tata Tea in September 1988 when it made a public offer to take over Consolidated Coffee Ltd. And acquired 50 percent of the company's equity from resident shareholders in December 1989.

Merger and acquisition activities continued to take place in the manufacturing sector in India during the 1980s. Since 1986 onwards, both friendly Takeover bids on negotiate basis and a few hostile bids too, through hectic buying of equity shares of select companies from the stock market have been reported frequently.

b) Stature of the Corporate Control Market in India after Liberalization

The policy regime in the 1990s has greatly liberalized the possibility of industrial restructuring and consolidation through Mergers and Takeovers by removing various restrictions. With the adoption of liberalization policies in 1991, the Government omitted the relevant sections and provisions from the MRTP Act, 1969 involving pre-entry scrutiny, by the MRTP (Amendment Act), with effect from 27.9.91 (Sections 20-26 and Sections 28-30G of Chapter III, — "Concentration of Economic Power" were omitted). With this, the need for prior approval of the Central Government for merger and acquisition activities was abolished. The availability of flow of funds through global depository receipts (GDRs) and Euro-issues has reduced the problem of finance. This, together with the dismantling of the FERA controls in 1991, has led to a rise in the number of Mergers and Takeovers, actual and proposed the extent of which is shown in While there were 58 Mergers and Takeovers from 1988 to 1990, the number rose to 71 in 1991 and 730 in 1998. There was a jump in the number of merger and TO activities in India from 1988 to 1993, the average rate of increase being around 89% for the five-year period. Since then the rate of rise had maintained an average of 20.5%. Khanna (1998: 10) has referred this situation in India as the "first merger wave" in India.

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5. CONCLUSION

The first stylised fact about mergers is that each wave generally has the stamp of special factors; these normally lead to differing perceptions concerning asset

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values among economic agents, which in turn encourages mergers. Among the largest recorded waves in the United States first is that between about 1890 and 1905. This wave dominated by "mergers for monopoly" saw the creation of giant US firms that subsequently dominated the industrial landscape for much of the 20th century. Ironically, it is thought that the Sherman Antitrust Act of 1890, by outlawing cooperation between firms, thereby encouraged mergers.

Stigler labeled the 1920s wave as "mergers for oligopoly". The wave of the 1960s was characterized by conglomerate mergers and that of the 1980s by the "bust-up" of the same conglomerate mergers and by leveraged buy-outs. The 1990s merger movement, in contrast, has witnessed "size-increasing blow-up mergers" creating very large global players. This wave had its origin in new technology, globalisation and deregulation. We are sure that mergers normally come in waves. They are an enduring mystery and the search for a single explanation for their existence, growth and size continues. Consequently, no single definitive reason can be attributed for merger waves; however several possibilities can be considered. Research on this subject is evolving over time and scope for exploring other issues associated with M&As empirically plenty.

However, the present study has identified some very important issues having policy implications, which need to be empirically probed. This increasing mergers and acquisition activity and threats of it may encourage companies to embrace professionalism and competitiveness, which could lead to outstanding performance of the global economy in general and Indian economy in particular.

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