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Market response to internationalization strategies: Evidence from Indian cross-border acquisitions

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Abstract The paper provides evidence that shareholders of acquirer Indian corporations engaging in cross-border transactions experience a statistically significant positive average abnormal return on the announcement day as well as cumulative average abnormal returns over multi-day event windows. The gains are significantly positive and higher for the acquisitions of targets in developed markets. The regression analysis in the paper highlights that cross-border acquisitions of high tech sector target firms in developed markets generate better wealth. Further, relatively larger acquisitions create higher gains.

Introduction

Internationalization is the process of increasing involvement in international operations across borders (Welch & Luostarinen, 1988). Internationalization strategy has been a major dimension of the on-going strategy process of majority of emerging multinational firms. Internationalization strategies depend on the dynamism of prevailing conditions in global as well as domestic markets. Internationalization of firms from emerging economies is also motivated by learning objectives that allow these firms to overcome the initial resource hurdles arising due to technological gaps (Li, 2010). As a result of the liberalization policy since 1991, the Indian economy witnessed dramatic growth, changes in domestic market, and firm activities specifically in relation to their expansion strategies across borders. Indian firms began to develop their existing skills in production capabilities and process R&D by acquiring technology focussed firms in advanced markets. Indian companies are venturing abroad in the software, biotechnology, automotive and oil sectors. Companies such as Ranbaxy Laboratories, Dr. Reddy's Laboratories, Wockhardt Ltd, and Nicholas Piramal India Ltd in the pharmaceutical

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sector; software companies like Tata Consultancy Services, Wipro, in the information technology sector; and Bharat Forge Limited in the automobile sector have successfully adopted internationalization strategies and have become globally competitive. India has transformed its image from being a foreign direct investment (FDI) destination to a major emerging foreign direct investor (Pradhan, 2008).

The strategies adopted by Indian companies for their internationalization are: outsourcing, geographic diversification, joint ventures, and cross-border mergers and acquisitions.

Cross—border acquisitions are an important corporate strategy that enables firms to extend their current businesses to new markets, leverage their current capabilities, and diversify into related markets. In addition, cross—border acquisitions can be an important mechanism for corporate governance convergence (Wang & Xie, 2009). The acquisition based strategy of internationalization adopted by Indian enterprises in recent years by acquiring strategic assets such as technology, known brands, access to customers, and global footprints has resulted in the emergence of new corporate players on the global scene from an emerging economy (Kumar, 2008). Acquisition is the route preferred by Indian corporates for international expansion as compared to organic routes adopted in developed markets. Kumar (2008) documents that motivation for cross-border acquisitions and outward FDI has shifted from market-seeking strategies (during 1970s and 1980s) to strategic asset-seeking strategies recently. He also reports the changing pattern in investment flow to developing countries during 1990s to developed countries in 2000s. Pradhan (2004) analyses the determinants of internationalization of Indian manufacturing firms. He suggests that the production activities of Indian firms abroad are influenced by liberalization initiatives during the 1990s to a certain extent. India's economic environment during liberalization went through many transformations such as removal of restrictions on imports, liberalization of FDI policy and launching of several trade promotion measures. The Indian pharmaceutical and IT industries chose internationalization as an important part of their strategy to succeed in this new liberalised policy regime.

The last two decades have witnessed significant internationalization of firms from emerging markets in terms of their greater participation in international trade, growing outflows of FDI, and a surge in their cross-border mergers and acquisition activity. The internationalization activity of firms from emerging economies may reflect attempts to acquire strategic assets such as new technologies and brands, and to secure access to raw materials and distribution networks. In sum, rather than exploiting existing assets, FDI may reflect attempts to acquire or augment strategic and other assets. AT Kearney's (2008) study of global mergers and acquisitions (M&A) reveals that India has been at the forefront of the M&A activity among developing countries. Indian acquirers accounted for 29 percent of M&A deals by developing market firms during 2002—2007.

In this context, the present paper aims to examine the stock price reaction to the announcements of cross-border acquisitions and to investigate if cross-border acquisition announcements create value for the shareholders of the acquiring firm in the short-term. The objective of the present paper is to examine the short-term abnormal returns to the shareholders of acquiring companies. Internationalizing with cross-border acquisitions also helps the acquirers to increase operational efficiency and flexibility by exploiting market imperfections and expanding beyond boundaries. However, these factors influence the acquirers differently when the target firms are located in developed markets as against emerging markets (Brouthers & Brouthers, 2000; Krugman, 1991; Shrivastava, 1986). Indian acquirers are expected to experience synergies from acquiring target firms in developed markets by gaining access to the production and new technology know-how and distribution channels. Indian firms are acquiring target firms in established and mature markets to realize synergies of the low-cost base structure. It also facilitates the acquiring firms with the strong management expertise of target firms in developed markets. The target firms in emerging markets offer unique challenges to the acquirers as these markets are at a different level of economic development. Little transparency, and lack of available information tend to hamper the process of due diligence when the target firms are located in emerging markets (Bhagat, Malhotra, & Zhu, 2011; Kose, Steven, Nguyen, & Vasudevan, 2010). To explore the factors influencing the direction and magnitude of market reaction, the disaggregate analysis for returns due to announcement of cross-border acquisitions has also been attempted. The disaggregated analysis has been done in terms of targets in developed and emerging markets. The present paper observes that cross-border acquisitions create value for the shareholders of the acquiring firm. The regression analysis in the paper highlights that cross-border acquisitions of high tech sector target firms in developed markets generate better wealth. Further, relatively larger acquisitions create higher gains.

For better exposition, the paper is organized into six sections including this section. The second section reviews the previous empirical research work related to cross-border mergers and acquisitions. The third section explains the methodology used. Data collection and sample selection related issues have been delineated in the fourth section. The major findings and concluding observations are contained in the fifth and sixth sections respectively.

Review of literature

There is voluminous literature analysing the success of mergers and acquisitions activity. The purpose of this paper is to assess the success of cross-border acquisitions predominantly from the point of view of the shareholders of the acquiring companies. Accordingly, the review of empirical work is primarily focussed on studies measuring the implications of cross-border transactions on the shareholder wealth of the acquiring companies. Many studies have used the event study methodology and found a positive short-term announcement effect of the cross-border M&As on the acquiring firms' stock returns (Harris & Ravenscraft, 1991; Markides & Ittner, 1994; Morck & Yeung, 1992). Contrary to this, studies on acquirers of domestic firms have found on an average negative or at most insignificant return for the shareholders (Healy, Palepu, & Ruback, 1992; Mitchell & Stafford, 2000; Sirower, 1997; Walker, 2000).