

**RISING MULTINATIONALS: EXPLORING OUTBOUND ACQUISITIONS BY
INDIAN CORPORATIONS**

I. Introduction

A. In the past decade, as part of their globalization efforts, Indian multinational corporations (“MNCs”) have launched multimillion and multibillion dollar deals to acquire companies around the globe. This rise in outbound mergers and acquisitions (“M&A”) activity by Indian MNCs has attracted considerable international attention.

1. Indian MNCs often sought expansion into foreign markets that are unlike their home market, and many Indian MNCs specifically targeted acquisitions in developed countries.

a. The focus of Indian MNCs on acquisitions in developed countries, in particular the United States and the United Kingdom, appears to be one of the few documented instances where companies from emerging markets have been able to successfully take over western companies.

2. While transactions have decreased as a result of the global financial crisis, increasing cross-border M&A activity by Indian MNCs is a trend that will likely continue.

B. Three key factors have been cited as contributing to the rise of outbound acquisitions by Indian MNCs. Each of these factors can explain why Indian MNCs have launched outbound M&A transaction, but they do not necessarily explain why they have targeted firms in the US and UK.

1. India’s recent economic liberalizations and the end of the “License Raj.”

2. Indian MNCs’ relatively easy access to multiple sources of funding, including both domestic and foreign capital markets.

3. Practical benefits for business expansion through acquisitions of foreign corporations.

C. The role of law and culture in promoting outbound acquisitions by Indian MNCs in the UK and the US has been largely unexplored.

However, some studies suggest that a common language and lower informational costs have a positive effect on the size and direction of cross-border M&A flows.¹

¹ Julian Di Giovanni (2005), *What drives capital flows? The case of cross-border M&A activity and financial deepening*. *Journal of International Economics*, 65(1): 127–149.

D. The goal of my project is two-fold.

1. First, my project aims to document the increased use of acquisition strategies in the west by Indian MNCs as they embark on an internationalization path.

2. Second, my project aims to examine the extent to which familiarity with legal culture, particularly regulatory frameworks in the United States and the United Kingdom, played a role in advancing outbound acquisitions by Indian MNCs in developed countries.

II. Outbound M&A Activity by Indian MNCs

A. Overview of the growth in outbound M&A:

1. Outbound M&A activity from 2001 – 2003 among Indian firms averaged around \$1 billion per year.

2. India's outbound cross-border M&A activity increased from 2004 to 2006. Activity peaked in 2007, totaling more than \$35 billion in value.

a. By 2005, India completed 467 deals reaching a total of \$18.2 billion. The average size of each deal was nearly \$40 million. Of the 467 deals, 192 were foreign acquisitions by Indian corporations. India's outbound M&A deals generated \$9.5 billion, representing 58% of the year's deal value.

b. Indian cross-border mega deals peaked in 2007. Some studies suggest that in 2006 and the first half of 2007, Indian MNCs engaged in more M&A activity abroad than foreign multinationals invested in India.

B. Types of Indian MNCs involved in outbound M&A

1. Indian acquirers consisted primarily of private-sector firms. These acquisitions ranged from multibillion-dollar deals involving large, diversified business houses, such as the Tata Group, to smaller pharmaceutical and technology companies.

2. Small and mid-cap companies also represented a significant portion of outbound M&A activity.

3. As the pace of deal-making activities increased, Indian firms began purchasing much larger foreign companies in various sectors, including information technology ("IT"), pharmaceutical, manufacturing, energy, steel, and automotive industries.

C. Legal characteristics of acquisition activity

1. Deals were typically "plain vanilla" mergers.

2. Indian companies tended to structure their deals as friendly, cash-only acquisitions.

D. Location of the Target Companies

1. Indian MNCs often sought to expand to markets in developed economies by acquiring Western companies located primarily in the United States, United Kingdom, and Western Europe.

E. Ongoing trend?

1. With the deepening of the financial crisis in 2008, the number of total M&A projects declined by 37.5%, investments in new projects declined by 43.1%, and, overall, India's M&A activity fell by \$14.8 billion. In 2008, Indian companies completed a total of 193 outbound cross-border deals totaling \$13.15 billion.

2. Two theories have sparked a debate as to whether the cause of this decline in outbound M&A activity can be attributed to the global economic crisis or the byproduct of strategic business planning by the Indian MNCs.

a. Global and Domestic Economic Crises: The current global economic environment has adversely affected the ability of Indian MNCs to purchase foreign companies. The credit squeeze has influenced corporations' ability to launch deals. In addition in September 2008, Indian and Asian stock markets plunged nearly a third. This severely limited financing options.

b. Strategy: Some commentators attribute the decline in outbound M&A activity to business strategy. Indian corporate leaders may be waiting to enter deals as foreign assets continue to reduce in value. Indian corporations possess enough cash reserves to continue outbound M&A activity. They may simply be shifting back to a more cautious stage in their business development and may be waiting for the global economy to stabilize.

III. Factors Leading to The Rise in Outbound M&A

A. General reasons explaining increased outbound M&A activity by Indian firms include: economic liberalization, global and domestic economic conditions, and business goals and expansion efforts designed to promote Indian competitiveness among the global community.

1. Economic Liberalization and the end of the "License Raj"

a. The "License Raj."

i. This term refers to the period between 1950 and 1990 in which the Indian government imposed strict licensing regulations as an attempt to promote Indian businesses. These regulations include high import and production control. Governmental regulations prohibited all outbound investments except minority-owned joint ventures. Cash was not permitted as consideration. Companies were required to obtain specific government approval for foreign joint ventures.

ii. Traditionally, commentators have viewed the License Raj as detrimental to the Indian economy. However, the License Raj may have set the stage for the current wave of outbound acquisitions. Because Indian corporations were shielded from the rest of the world, Indian corporations were able to sustain domestic growth, increase corporate earnings, and strengthen their balance sheets. This led to Indian corporations becoming cash rich, and, along with the dismantling of the License Raj, helped enable Indian MNCs to acquire foreign companies.

b. The “Balance of Payments” Crisis & Economic Reforms.

i. In 1991, India faced the “Balance of Payments” crisis, which initiated a need for government reform. It dismantled the License Raj. In response to the crisis, the Indian government lowered taxes and tariffs, encouraged private sector competition, and supported globalization efforts.

ii. Additional reforms promoted M&A activity. These include the Indian government passing the Foreign Exchange Management Act in June 2000; enacting the “Automatic Route,” which enabled Indian corporations to fund 100% of their worth abroad; and liberalizing the number of remittances able to be sent to India from foreign acquired companies. International regulatory changes also enhanced the feasibility of Indian firms to acquire companies abroad.

2. Domestic and Global Economic Conditions

a. Financial deregulation provided Indian firms with enlarged access to domestic capital markets.

b. In addition, governmental liberalization led to greater access to international foreign markets.

3. The Business Reasons

a. In the post-liberalization period, Indian firms viewed overseas expansion as necessary to global competitiveness.

b. IT outsourcing into India created a new class of professionals eager to expand their businesses into the global market.

c. Acquiring established companies provides firms with a consumer base and market shares in competitive markets, the ability to consolidate manufacturing costs, and allows for diversification of products.

B. I argue that two often overlooked factors have also contributed to outbound mergers and acquisitions by Indian MNCs.

1. Cross-border M&A transactions can involve high informational and transactional costs, including legal costs. These legal costs can be more pronounced when firms are required to work in and learn about a new

legal system. There may be a number of benefits for firms to acquire targets in a legal system with which they have some familiarity.

2. India's regulatory standards with respect to M&A transactions

a. Indian law provides guidelines for the manner in which Indian corporation must acquire other Indian companies. However, there is no express legal provision governing cross-border acquisitions of foreign firms by Indian companies. Indian companies must follow the takeover regulations of the target company's country.

b. Complexity of takeover regulation and similarities to US and UK regulations

i. India's takeover code is modeled after the U.K. City Code on Takeovers, and recent amendments appear to be modeled on certain provisions in the Williams Act.

ii. This is a potential factor in explaining why Indian companies choose companies residing in developed nations such as the United States and the United Kingdom. Indian firms may have targeted firms in jurisdictions with takeover regulations that parallel those found in India in order to lower transaction costs.

3. Cultural Familiarity with U.S. and U.K. legal systems

a. Indian corporate leaders do not face barriers to communication with western target companies. India's official language in business is English, and its legal system generally reflects British common law traditions.

b. These factors create a familiarity with regulatory and legal issues surrounding cross-border acquisitions in the West.

IV. Conclusion