

Opportunities and Challenges of M&A in India

By

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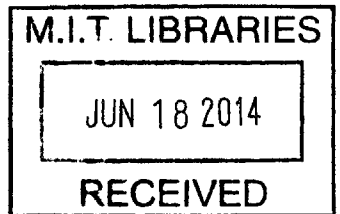
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By

Nikhil Gupta

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ABSTRACT

The Indian economy has witnessed a major transformation since the government of India introduced the liberalization policies in 1991. Since then M&A activity in India has picked up pace as foreign companies began to enter and expand their footprint in India. In developed economies especially the US and western Europe, M&A has been prevalent for a long time and is used as a major tool in corporate restructuring. India will continue to present itself as an attractive investment destination due to its high economic growth rate, growing middle class, favorable demographic divide and exceptional management talent. However M&A in India is a challenging proposition primarily due to the nature of its business holdings. Majority of companies in India are promoter held and their motivation of doing deals is different from that of firms run by professional management. Further the regulatory framework is still evolving and needs to be carefully analyzed to prevent post deal issues. In order to achieve the intended results companies must choose an appropriate sector, find relatively small but growing firms and acquire majority stake in those firms. It is imperative to build and manage relationship with the promoter family long before the initiation of deal activity. This would enable firms to be successful in their endeavors, mitigate potential risks and achieve desired synergies.

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*To my dearest wife, Neelima Jain and loving daughter Nakshita
For your self-giving sacrifice for our love and family*

*To honorable Professor S.P. Kothari
For your invaluable support, understanding, and direction*

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1 INTRODUCTION AND SUMMARY

India has emerged as one the most favored emerging market destination for inbound M&A deals over the past decade. The main reasons for this are a strong Indian economy, huge demand for goods and services in India due to its demographic profile and available resources in terms of labor and capital that can be leveraged to add value to the acquiring firms.

Mergers and Acquisitions (M&A) in India, both inbound and outbound, has gained prominence in the last two decades. Since then Indian government has taken several steps to encourage MNC's to conduct business in India by progressively opening Indian market to foreign companies, the latest being increasing FDI in multi brand retail to 51%.

However, the deal process in India still is quite challenging for foreign investors and there are instances where such ventures have not yielded desired results. Holdings in Indian businesses are primarily in the hands of entrepreneurs or promoters. This makes the entire exercise of M&A different from that in the US where most firms are run by professional management. Further the regulatory framework itself is constantly evolving and needs to be understood in detail by the both acquiring and target firms before they could finalize the deal.

The nature of M&A deals in India can be classified into three different types depending upon the origin of the acquirer and target firms. First is the inbound M&A, where a foreign entity such as a multinational firm acquires a stake in Indian firm. Second is the outbound M&A wherein an Indian firm buys a firm located outside India. The third type is the domestic M&A where an Indian firm buys another Indian firm.

In this thesis I aim to address the foreign and multinational companies who are planning an inbound M&A deal in India or are considering India as next possible destination to expand their business.

The key questions I intend to answer through this thesis.

- Why does India present an attractive destination for inbound M&A?
- What are the key challenges foreign firms faces while conducting M&A in India?
- How can such firms plan and act in order to face those challenges?

1.1 Focus and Methodology

The thesis focuses on three main areas

1. Comparative analysis of M&A trends in India and USA
2. Why India presents an incredible opportunity for investments and M&A
3. Challenges of doing M&A in India

The methodologies used in the thesis vary from section to section.

In this thesis I will initially describe the concept of M&A, various types and motivation for M&A activity. Thereby I will compare the M&A landscape in India and US. In particular I will analyze the M&A activity in past in India which would give a guidance to future deals. The data for the analysis has been gathered from a number of sources as mentioned in the Appendix.

Next I will also present some of the main reasons why India is such an attractive destination and use a case study of Abbott Laboratories acquisition of Piramal health as to elaborate on opportunities that exists in Indian market. The acquirer in this case has been successful in its endeavors post its acquisition in India.

Thereafter I will analyze the difficulties and challenges faced by acquirers while conducting deals in India. In later sections I will discuss specific challenges firms face over the deal cycle in India i.e. identifying the appropriate target, valuing the target firm, negotiations, and post deal integration issues. This would be followed by challenges in terms of laws and regulations around M&A in India. Finally I will present steps and recommendations for companies to take into consideration while doing inbound M&A deals in India and thereby mitigate the risks and obtain the desired synergies.

1.2 Conclusions

The paper presents the following conclusions:

- M&A in India has been growing for the last decade except for two major downturn cycles: Tech crash in 2001 and financial crisis in 2009. However more recently India as not been able to meet its growth expectations and therefore the M&A activity struggles to reach historic heights. As M&A in India matures the trends would become more align to those in developed markets.
- India presents as opportunity to do business due to its growing middle class, favorable demographic divide, independent judiciary system and an active marketplace due to innovation and entrepreneurial focus.

- The major challenges that a foreign entity faces during the deal cycle is initially sourcing the right target for acquisition. Further since most businesses are promoter owned it becomes difficult for firms to gain full knowledge regarding the corporate governance practices, financial statement disclosures and building business plans.
- Arriving at the valuation is another hurdle as the promoter attaches an emotional premium to the deal and needs to be considered. Further since not many comparable transactions are available, getting to an acceptable valuation is a challenge.
- The regulatory framework in India for M&A transactions is still a work in progress but new laws such as the Companies Act 2013 and Takeover Regulations 2011 are expected to ease the investment climate in India.

1.3 Recommendations

India is and will remain an opportunity for foreign investors more so because growth has been stagnant in developed economies and India's projected fundamentals look promising. It is better to acquire a majority stake in a small and growing firm in a sector rather than acquiring a minority stake in a well established organization. This will help the acquirer to drive the intended synergies. In order to mitigate risks the foreign entity has to develop relationship with the promoter family before any deal could take place. This involves setting clear expectation regarding future role of promoter, educating him regarding the deal process and valuation methodology. The acquirer should start cultural and management integration from day one. The deal process is complex and challenging but patience is the key and can lead exceptional results in future.

2 BACKGROUND RESEARCH

2.1 What is Mergers and Acquisitions (M&A)

Mergers & acquisitions (M&A), in the broad sense imply a number of different transactions ranging from the purchase and sales of undertakings, concentration between undertakings, alliances, cooperation and joint ventures, to the formation of companies, corporate succession/ ensuring the independence of businesses, management buy-out and buy-in, change of legal form, initial public offerings and even restructuring (Picot, 2002, p.15).

The two terms Mergers and Acquisitions though often used together are quite distinct in terms of the final outcome of the deal activity. Merger is the combination of two or more companies in creation of a new entity or formation of a holding company (European Central Bank, 2000, Gaughan, 2002, Jagersma, 2005). Acquisition is the purchase of shares or assets of another company to achieve a managerial influence (European Central Bank, 2000, Chunlai Chen and Findlay, 2003), not necessarily by mutual agreement (Jagersma, 2005).

2.2 Types of Mergers

There are a number of ways to classify mergers. One classification is horizontal, vertical and conglomerate merger.

Horizontal merger: Horizontal mergers are a transaction where a competitor buys another competitor with the purpose to obtain economies of scale in overlapping operations and to eliminate competition (Sevenius, 2003; DePamphilis, 2003). This type of transaction occurs when companies offer the same or closely related products or services in the same geographical market (Buono & Bowditch, 2003). Example of horizontal acquisitions include Exxon and Mobile (1999), NationsBank and Bank of America.

Vertical merger: Vertical mergers are best understood as a transaction where a customer buys a supplier or vice versa with the purpose to reduce transaction costs between the corporate value chains (Sevenius, 2003). The corporate value chain is defined as making something of value with raw resources, driven by different departments within a company where departments are for example, logistics, production, marketing, distribution, sales and customer support (DePamphilis, 2003). In order to exert more control over its operations, an organization can choose to acquire a supplier (backward integration) or a company that could distribute its products and services (forward integration) where the rationale is often defensive (Buono & Bowditch, 2003) for instance to stop a supplier from engaging in direct sales or to stop a customer from developing its own supply capability (Hopkins, 1983).

Conglomerate merger: Diversified conglomerate mergers are transactions where the buyer company allocates a portfolio of multiple companies with different kinds of businesses without any clear collaborative synergies (Sevenius, 2003). A conglomerate merger represents a third classification, not strongly horizontal or vertical, and having

few characteristics of either. An example would be U.S steel's acquisition of Marathon Oil to form USX (DePamphilis, 2003). Conglomerate mergers are overall seen as an evil transaction according to Felton (1971) because they promote a dangerous concentration of economic power and also diminish the effectiveness of competition.

Another classification can be given as hostile or friendly depending upon the nature of the bid and deal between the two companies. Hostile and friendly M&A reflects the people's attitude, i.e. in what way the transaction is perceived.

Hostile merger: A hostile transaction is when the targeted company's board of directors opposes the bid from the buyer (Sevenius, 2003), or when the target was not seeking a merger at the time of the approach (DePamphilis, 2003).

Friendly merger: A friendly takeover is when the targets management is receptive to the idea and recommends shareholder approval (DePamphilis, 2003; Buono & Bowditch, 2003).

2.3 Motivations for Mergers and Acquisitions

The motivations of companies for mergers and acquisitions are varied. Several theories have been put forward to identify the intent of these mergers. The most well known theories are efficiency theory, monopoly theory, raider theory, valuation theory and empire building theory. The major reasons why firms undertake M&A are as follows:

Synergy: Operational synergy is one of the most cited reason and rationale for M&A activity. If two firms have partially shared value activities, their merger could have cost savings because of economies of scale. For instance, two firms can share operational facilities and thus save cost. Companies can improve processes too by aligning two firms' operation. Each company has its own advantage on certain process and hence a merger makes both companies take advantage of each other. In addition, revenue could increase as post-merger firm will have more product lines and therefore more revenue sources.

Market Power/ Market Entry: A significant motive for mergers and acquisitions is that it helps acquirer increase its market power through increase in size. Increase in market shares leads to increase in industry concentration, which provides firms with greater growth opportunities, more control over supplier and customers and pricing power in the market. Moreover M&A provides an effective mechanism for companies to enter a new market. Although firms could enter a new market and grow organically but that is slow. Mergers give companies access to suppliers, customers and distribution channels which the acquirer can integrate and expand as per his needs.

Diversification: A firm can enter new business area by merging with a firm in a different production area and thus allocate capital efficiently relative to the market. As well known in corporate finance field, less than perfectly correlated cash flow streams provide diversification and decreases the cost of capital, especially to some extent in emerging markets where well-developed capital markets are still rare. Besides, diversification creates value by dispersing managerial talent. As in many cases, managerial talent is

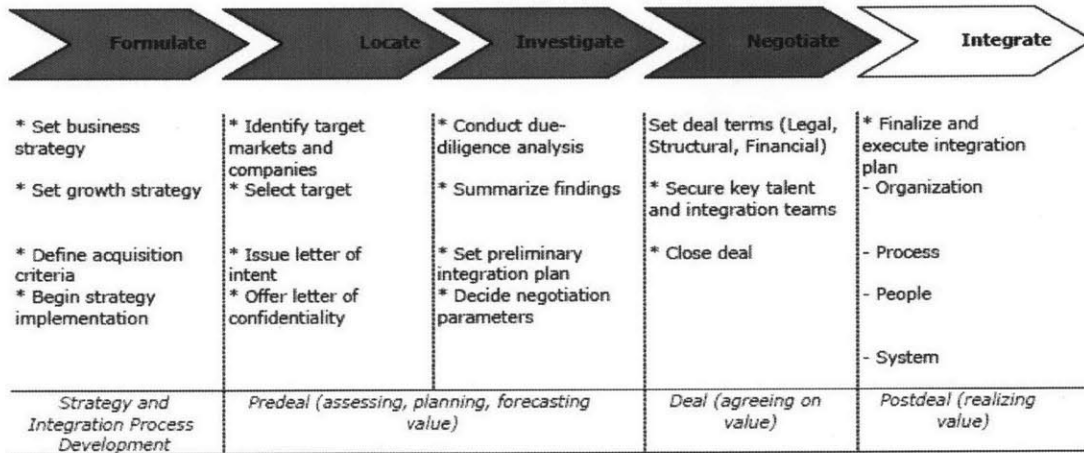
scarce buy scalable. Hence, diversification can let good managers manage even bigger firms.

Managerial Incentives: This incentive for mergers mainly comes from agency problem, as managers maximize their own return rather than shareholders'. First, diversified cash flow makes firm safer and less likely to bankrupt, and then provides them job security. Second, managers have incentive or motivation to run a larger company just for excessive pride and compensation.

Strategic Reasons: Sometimes, even if an acquisition or merger has a negative cash flow, it may provide strategic options for potential cash flow in the future. Further there might be information asymmetry between the market and the firm and the acquirer feels that it can act upon this and create value for itself.

2.4 M&A Deal Cycle

The below figure depicts the various stages in the M&A deal cycle.



Source: Adapted from Galpin and Herndon (2000, p.9)

Figure 1: Steps in a M&A deal cycle

The following steps broadly classify stages of a typical deal cycle of during the M&A process.

Formulate M&A Strategy: A merger or acquisition begins with a M&A strategy. As elaborated from the last part, there are numerous motivations to make M&A, so companies have to fully understand why they need to do M&A. The reason should essentially fit in the long term business and the growth strategy of the firm.

Target Identification: After identifying M&A strategy, company will source ideal target for M&A. This involves finding the target market and then locating the possible

companies that could be a potential fit for the acquirer. It is usually a tough process and very uncertain. Beginning from selection plan, acquirer Company will narrow down targets to a certain industry and initial several targets companies. The real sourcing process would be done in several rounds. The first round is relatively quick as acquiring firms would only select those targets who match their M&A strategy. The second round is more about initial evaluation of the targeted company based on the information gathered.

Target Valuation and Due Diligence: As soon as M&A target is identified, the M&A process goes to due diligence. Due diligence is the process of thorough analysis of targeted company in order to make M&A decision. Before acquiring companies make due diligence, they would prepare due diligence model, timeline, and so on. Then they will conduct due diligence, including collecting all required information in the model, writing M&A analysis report, and even discussing with intermediary agencies about cooperation. After this process, acquiring firms will evaluate merger opportunities and thus make decisions.

Negotiations and Deal Closure: By making due diligence, acquiring firms would choose the target to invest. Deal structure is an agreement made between acquirer and target defining the rights and obligations of the parties involved. In terms of M&A strategy, integration process, capital tools, financing cost, and risk, acquiring firms would define the entire deal structure with targeted company. With the service of law firms and financial advisory firms, acquiring firms would then standardize term sheets and begin to

negotiate with the target company. As long as both parties reach to an agreement for all terms, they will sign M&A agreement and finish deal negotiation.

Post Completion Integration: Once M&A deal is sealed, the integration process begins.

Integration is an important step of successful M&A. Whether integration is successful could determine the success of entire merger, including strategic goal, operational synergy, and financial forecast. Integration usually involves the integration in corporate culture, management, operation and production, human resources, and so on.

3 LITERATURE REVIEW OF M&A IN CONTEXT TO INDIA

In this section I would review the current literature relevant to the topic. I have divided the section into three parts based on the issues I will present later in the thesis. The broad classification used to research for relevant literature is outcome of M&A in India, M&A in Indian context and motivation for conducting M&A in India.

3.1 Outcome of M&A in India

While going for mergers and acquisitions (M&A) management think of financial synergy and/or operating synergy in different ways. But whether they are actually able to generate any such potential synergy or not, is an important issue. *Kumar & Bansal (2008)*, in their study, try to find out whether the claims made by the corporate sector while going for M&As to generate synergy, are being achieved or not in Indian context. They do so by studying the impact of M&As on the financial performance of the outcomes in the long run and compare and contrast the results of merger deals with acquisition deals. This empirical study is based on secondary financial data and tabulation. Ratio analysis and correlation are used for analysis. The results indicate that in many cases of M&As, the acquiring firms were able to generate synergy in long run, that may be in the form of higher cash flow, more business, diversification, cost cuttings etc.

Sudha Swaminathan (2002) studied a sample of five mergers during 1995-96, and found that four of the five acquiring firms improved operating and financial synergies (measured through certain financial ratios) three years after the merger. While net profit

margin significantly improved post-merger, the asset turnover did not show significant change – the study concluded that shareholder value improved for the mergers of smaller companies, but not for mergers of large companies.

Empirical testing of operating performance following mergers of Indian companies has been quite limited so far, and focused specifically on manufacturing sector, using small samples or individual cases, and over limited periods of time.

3.2 M&A in Indian context

Researchers have tried to investigate various aspects of M&A in India (Basant 2000, Kumar 2000, Beena 2001, Agarwall and Aditya 2006). As for predicting the targets of M&A and identifying the motives, the literature is scarce. Few papers have tried to predict the targets and determine the characteristics of acquiring firms like Rajesh and Prabina (2007) on manufacturing industries, Priya Bhalla (2010) on financial sectors and Sangeeta (2010). All these papers have adopted theories and models from west into Indian context directly to validate their hypothesis.

Bhaumik and Selarka (2008) discuss the impact of concentration of ownership on firm performance. On the one hand, concentration of ownership that, in turn, concentrates management control in the hands of a strategic investor, eliminates agency problems associated with dispersed ownership. On the other hand, it may lead to entrenchment of upper management which may be inconsistent with the objective of profit (or value) maximization. Their paper examines the impact of M&A on profitability of firms in

India, where the corporate landscape is dominated by family-owned and group-affiliated businesses, such that alignment of management and ownership coexists with management entrenchment, and draws conclusions about the impact of concentrated ownership and entrenchment of owner managers on firm performance. Their results indicate that, during the 1995-2002 period, M&A in India led to deterioration in firm performance. They also found that neither the investors in the equity market nor the debt holders can be relied upon to discipline errant (and entrenched) management. In other words, on balance, negative effects of entrenchment of owner manager negate the positive effects of reduction in owner-vs.-manager agency problems. Their findings are consistent with bulk of the existing literature on family-owned and group affiliated firms in India.

Kumar and Rajib (2007) discuss the characteristics of both the acquirer and the target firms in India between the years 1993-2004. Using logit regression they concluded that The acquirer firms have higher cash flow, higher PE ratios, higher book value, higher liquid assets, and lower debt to total assets ratio which are statistically significant when compared to the target firms. The acquired firms were smaller, had lower PE ratios, lower dividends payout, and lower growth in sales and assets. The acquirers had higher cash flows and lower leverage which, in principle, go with the agency theory. They further develop and prove the hypothesis that lower the liquidity position of the firm, greater is the likelihood of the firm becoming a target for acquisition and higher the leverage, greater is the probability of a firm being acquired.

3.3 Motivation for conducting M&A in India

R Srinivasan and Bibek Prasad Mishra have identified several major motivations for firms undertaking M&A in India. Based on comments from top management of sixty firms they have proposed that horizontal acquisitions by market leaders are likely to result in strengthening market power. They further conclude that domestic firm's sell-off to MNC's may help them gain market entry and help generate cash to fuel target firm's growth opportunities. Finally multinational companies may offer higher premiums for acquiring domestic target than domestic acquirers.

Kumar and Rajib (2007) have examined a sample of 227 acquirer and 215 targets companies during the period 1993-2004. They have observed capital structure characteristics as a main motive for the merger for both acquirer and target companies in India. They reveal that firms with tighter liquidity positions are more likely to become a target.

4 COMPARATIVE ANALYSIS OF M&A TRENDS IN INDIA AND USA

In this section I would review the current situation of M&A in India and trends over the past decade to get the basic understanding. Further I present a comparative analysis of these trends with those seen globally and in US. USA is a relatively mature M&A market and I would analyze the similarities and differences between the two markets. The data for this section has been collected from SDA Platinum Database (Thomson), Mergermarket and IMAA.

4.1 Trends of M&A in India

M&A began to pick up pace post 1991 after the liberalization of Indian economy. During the pre-liberalization era there were really very few firms that had any intention and resources to involve in deal activity. Further the major motivation of companies at that time was diversification and buying sick units to turn them around. This however changed after 1991 when M&A was primarily done to consolidate the existing subsidiaries into large conglomerates. Further since opening of the Indian market a large number of foreign firms began to enter India to establish their business thus increasing the overall M&A activity in India. The table below presents the snapshot of the number of deals that happened in India pre liberalization.

Year	Mergers	Acquisitions	Total
1974-79	156	11	167
1980-84	156	15	171
1985-89	113	91	204
1990-94	236	646	882

Table 1: M&A deals in India before 1991

The above table depicts that the deals per year averaged at 35 for the period 1974-1979 and gradually increased to 176 for the period 1990-1994.

There was a huge spurt in the M&A activity post 1991 when the liberalization reforms for the Indian economy were put into place.

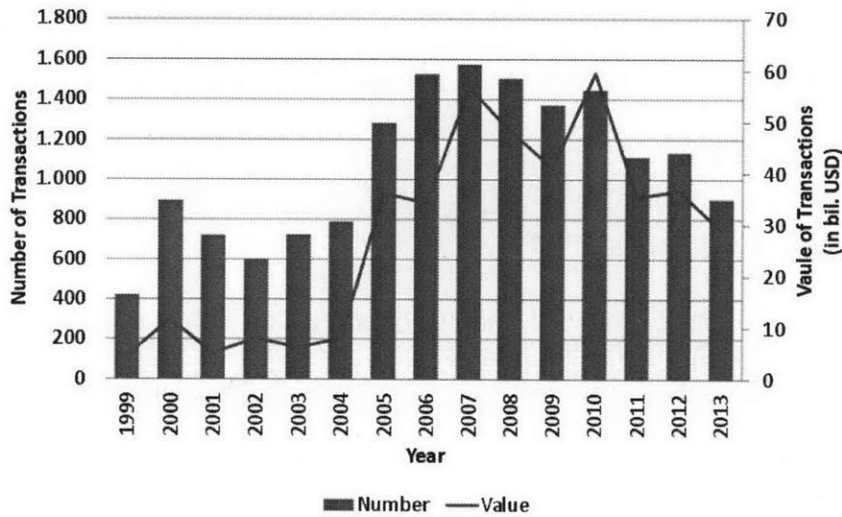


Figure 2: Announced Mergers and Acquisitions in India 1999-2013

Mergers and Acquisitions involving Indian companies reached US\$ 38 billion from 1160 deals in 2013. This was 20% down from US\$ 58 billion from 1428 deals in 2010 when Indian M&A witnessed its peak activity. From the above figure it becomes clear that M&A in India has on average witnessed an upward trend since 1999 with major exception being the tech bubble crash in 2001 and financial crisis in 2009. It is also noted that M&A activity has declined in the past three years. This can be attributed primarily due the inability to maintain a high growth rate (8-9%) as shown in the previous years and in is same lieu of the global M&A trend as discussed later in the section.

Now further we look at the breakdown of the M&A activity as inbound, outbound and domestic M&A

Indian M&A volume

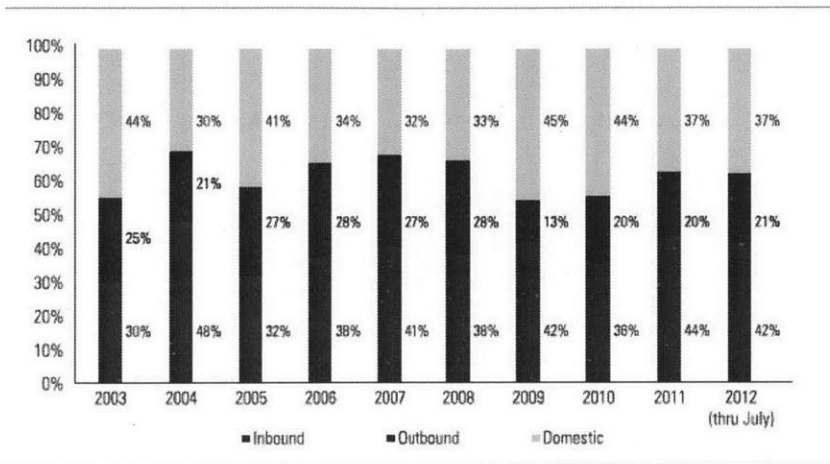


Figure 3: Break up Indian M&A deals

As shown by figure 3 Inbound M&A deals still constitute nearly 40% of the total M&A activity involving Indian firms. Moreover one third of deals are domestic deals involving Indian firms both as target and acquirers. In regards to the Indian inbound M&A, I see that the deals both in number and value have shown an increasing trend in since 2003. However there is a dip in inbound M&A activity post the financial crisis of 2008-09. But in recent years the inbound M&A activity has again picked up pace and bound to show similar trend in future. On further analysis from Figure 4, I conclude that inbound deals have shown an upward trend with major deals happening in either first or the last quarter of the year.

Indian inbound M&A

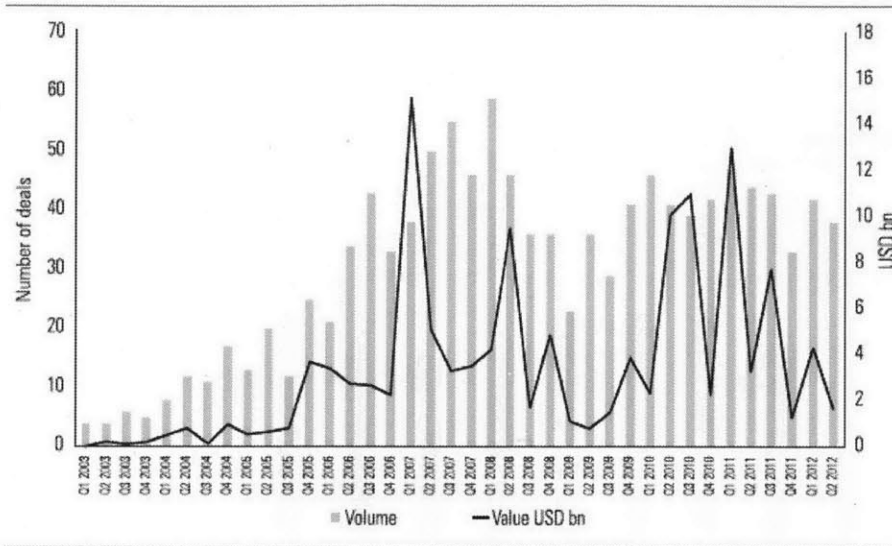


Figure 4: Inbound M&A Activity trend Quarter wise breakup (2003-2012)

In order to study the more recent trends I have presented a snapshot of M&A activity involving Indian firms for the past three years (2011-2013).

Deal summary in 2013	Volume			Value(US\$billion)		
	2011	2012	2013	2011	2012	2013
Domestic	216	234	220	5.04	6.08	5.75
Cross border	288	262	221	39.58	14.51	17.89
Mergers & internal restructuring	140	102	59	-	14.80	4.55
Total M&A	644	598	500	44.61	35.38	28.19
PE	373	401	450	8.75	7.38	10.39
Grand Total	1,017	999	950	53.36	42.76	38.58
Cross border includes						
Inbound	142	140	139	28.73	5.96	8.64
Outbound	146	122	82	10.84	8.55	9.25

Figure 5: M&A activity in India (2011-2013)

The above table presents some interesting observations. The first thing to notice is that the number of inbound M&A deals have almost remained constant for the past three years but the value of these deals have declined. This shows that foreign companies are not involved in large value deals for the past two years. This is in contrast to outbound M&A where although the number of deals has declined the total deal value has remained constant signaling Indian companies are increasing getting involved in large deals outside India. Another observation is regarding the private equity (PE) in India which has increased both in terms of number and value of investments made. PE has formed an integral part of investment strategy by foreign and Indian players with the intention of buying sufficient stake in the company to support the company towards the next phase of growth. Finally I want to conclude this topic by presenting top 10 deals in India for the period 2000-2009.

Rank	Year	Acquiror	Target	Transaction Value
				(bil. USD)
1	2007	Tata Steel	Corus	12.2
2	2007	Vodafone	Hutchison Essar	11.1
3	2007	Hindalco	Novelis	6
4	2008	Ranbaxy	Daiichi Sankyo	4.5
5	2009	ONGC	Imperial Energy	2.8
6	2008	NTT DoCoMo	Tata Tele	2.7
7	2008	HDFC Bank	Centurion Bank of Punjab	2.4
8	2008	Tata Motors	Jaguar Land Rover	2.3
9	2009	Sterlite Industries	Asarco LLC	1.8
10	2007	Suzlon	Reliance Power:	1.7

Table 2: Top 10 M&A deals in India till 2009

The largest outbound M&A deal that happened in India till date is the acquisition of European firm Corus steel but Tata Steel (Indian entity) for \$12.2 billion. Similar the largest inbound deal is Vodafone (telecommunication company headquartered in UK) acquiring the majority stake in Hutchison Essar in 2007 for \$ 11.1 billion.

4.2 Comparison with M&A trends in USA

A comparison of M&A trends with USA is essential to analyze the differences and get guidance for future M&A deal activity for India as the Indian market matures. It is evident from Figure 6 the M&A activity was more than that in India both in term of deal size and deal value with total value of deals crossing way above \$ 1 trillion since 1993. Further we see that the M&A activity trend is an upward sloping as in case of India. Since US is a matured market the M&A trend seems to follow the macroeconomic trends in the global economy. This is visible from the significant drop in transactions both after the tech bubble burst and financial meltdown. Similar to the trend in India the global M&A was on rise from 2002 to 2007. It is interesting to note that although the number of deals has been slightly increasing since 2009 the deal value is not following a similar trend.

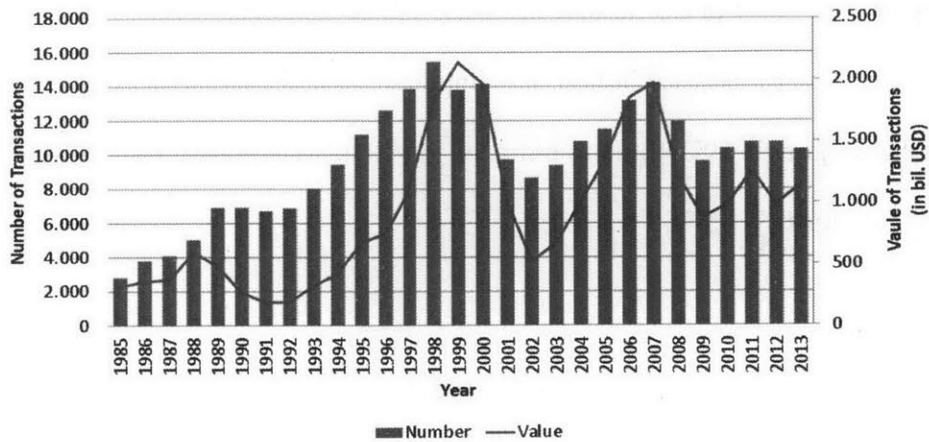


Figure 6: Announced Mergers and Acquisitions in USA 1985-2013

Finally I would like to present the top 10 deals that happened in USA till 2009

Rank	Year	Acquiror	Target	Transaction Value
				(bil. USD)
1	2000	American Online Inc	Time Warner Inc.	181.95
2	2001	Pfizer Inc	Warner Lambert Company	90
3	2008	Comcast Corporation	AT&T Broadband LLC	72
4	2009	Wells Fargo & Company Inc	Wachovia Corporation	68.11
5	2006	Pfizer Inc	Wyeth	68
6	2009	AT&T Inc	BellSouth Corporation	67
7	2002	NGMCO Inc	General Motors Corporation goods assets	66.6
8	2004	Pfizer Inc	Pharmacia Corporation	60
9	2005	JP Morgan	Bank One Corporation	57.4
10	2008	P&G	Gillette Company	57

Table 3: Top 10 M&A deals in USA till 2009

The largest M&A deal in US till date has been that of American Online (AOL) buying Time Warner Inc. for \$ 181.9 billion. It is important to note that the deal size is significantly higher in US. While in India the top 10 deals averages \$ 4.75 billion the similar figure for US is \$ 78.8 billion.

4.3 Comparison with trends in Global M&A

Finally to conclude this section I will explore the global M&A trends and see if the pattern is similar to that of India. Figure 7 is the data of global M&A both in terms of number of deals and deal volume. After comparing figure 2 and figure 7 I found that the macro trends of India M&A is similar to that of global M&A. The global M&A has witnessed downfall in overall M&A activity during and immediately after the technology bubble crash in 2001 and the financial meltdown in 2009. Further I see that although the deal activity although picked pace after 2010 it is nowhere near its peak.

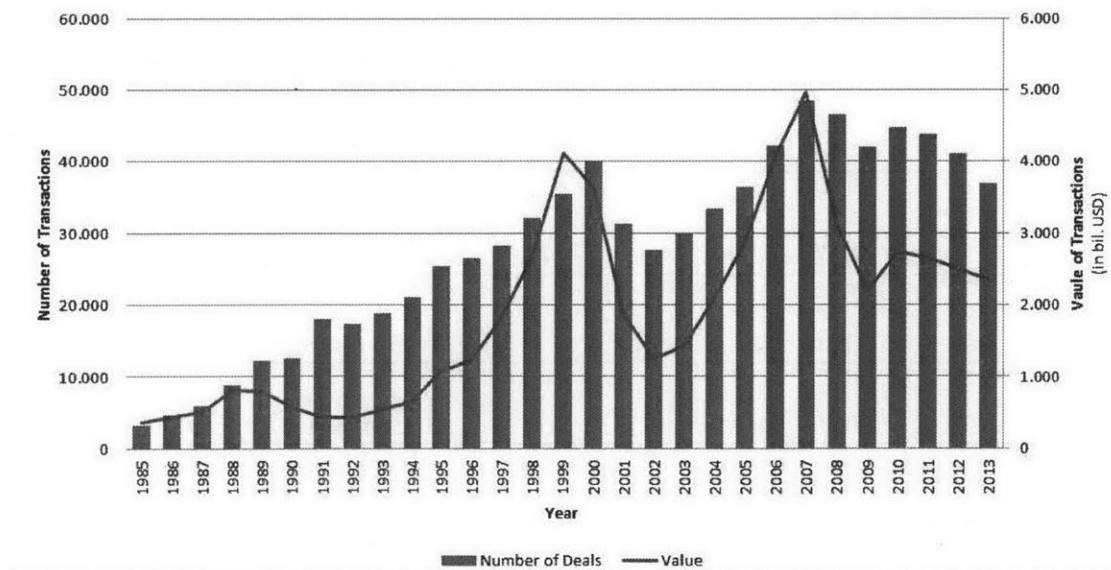


Figure 7: Announced Mergers and Acquisitions globally 1985-2013

I conclude this section by presenting the top 10 M&A deals that happened globally till 2009.

Rank	Year	Acquiror	Target	Transaction Value
				(bil. USD)
1	2000	Vodafone Airtouch plc	Mannesmann AG	194.75
2	2000	America Online Inc.	Time Warner Inc.(old)	181.95
3	2007	RFS Holdings BV	ABN Amro Holding NV	112.23
4	2000	Pfizer Inc.	Warner-Lambert Company	90
5	2005	Royal Dutch/Shell Group	Shell Transport & Trading Co plc, The	87.04
6	2007	Gaz de France SA	Suez SA	72.36
7	2001	Comcast Corporation	AT&T Broadband LLC	72
8	2008	Wells Fargo & Company Inc.	Wachovia Corporation	68.11
9	2009	Pfizer Inc.	Wyeth	68
10	2006	AT&T Inc.	BellSouth Corporation	67

Table 4: Top 10 M&A deals globally till 2009

5 INDIA- OPPORTUNITIES FOR INVESTORS

In this section I would first review the current state and future prospects of Indian economy. Thereafter I would give a brief description of the economic landscape present both during pre-liberalization and post-liberalization of Indian economy. Further I would discuss key factors that make India an attractive prospect to do business. I would also present arguments both from sellers' and buyers' perspective as to why M&A is an attractive proposition for each party in context to doing business in India. I would finally conclude the section with a case study of a successful M&A deal between Abbott Laboratories (a US pharmaceutical company) and Piramal Heath (an Indian healthcare and pharmaceutical firm).

5.1 Indian Economy at a Glance:

According to a white paper published by PwC, by 2050, the three largest economies in the world are likely to be China, the US and India. Currently the economy of India is the tenth-largest (\$1.824 trillion) in the world by nominal GDP and the third-largest (\$ 5.648 trillion) by purchasing power parity (PPP). India is one of the G-20 major economies and a member of BRICS. After a promising start to this decade, with GDP about 8% in 2010 and 2011, India's economy slowed to 5% in 2012, one of the lowest rates in the past seven years. Although current growth rate is less than that it was in previous years particularly after post liberalization, India continues to outperform the global economic growth and has done so by about 5% year on year for the past seven years. GDP (PPP) is projected to grow at approximately 8% over the next five years, as per the Economic

Survey report published by the Government of India in March 2013. However the growth forecast for 2014 was revised to approximately 5.3% in the midst of the global recessionary environment and European debt crisis. Therefore in light of the above evidence it can be reasonably concluded that Indian economy has strong fundamentals on which it is likely to grow for foreseeable future.

In order to better understand the evolution of Indian economy there are two main time periods in which Indian economy can be broken down and analyzed further. The first time period is pre-liberalization (1947-1991) and the second is post-liberalization period (1991-present).

The Pre- Liberalization Period: The Indian economic policy after independence was influenced by the colonial experience, and by exposure to British social democracy. The Indian policy makers at that time drew inspiration and roadmap from the progress achieved by the planned economy of the Soviet Union. Therefore, the domestic policy tended towards protectionism, with a strong emphasis on import substitution industrialization, economic interventionism, a large public sector, business regulation, and central planning, while trade and foreign investment policies were relatively liberal. The Five-Year Plans of India resembled policy of central planning as followed in erstwhile Soviet Union. Industries such as steel, mining, machine tools, telecommunications, insurance, and power plants were effectively nationalized in the mid-1950s.

The extensive regulation was sarcastically dubbed as the “License Raj”. The slow growth rate was named the “Hindu rate of growth”. The Indian currency, the rupee, was

inconvertible and high tariffs and import licensing prevented foreign goods reaching the market. The central pillar of the policy was import substitution, the belief that India needed to rely on internal markets for development, not international trade. This led to a lot of inefficiency across the industrial spectrum particularly due to lack of competition in the Indian market. Moreover as a consequence of this closed regime, India could neither gain access to latest technologies and best practices prevalent in the developed world nor had the resources to develop those technologies internally. Therefore in order to fuel its vast expenditure India took on huge loans from international market and gradually pushed itself on the brink of bankruptcy.

The Post Liberalization Period: A Balance of Payments crisis in 1991 pushed India to near bankruptcy. In order to rescue the Indian economy of that crisis, IMF bailout was secured for which gold was transferred to London as collateral. The Indian central bank refused new credit and foreign exchange reserves reduced to the point that India could barely finance three weeks' worth of imports. This was a turning point for Indian economy and in response to the International bailout package, India promised for the much needed economic reforms.

In response, the then Prime Minister Mr. Narashima Rao, along with his finance minister Dr. Manmohan Singh, initiated the economic liberalization of India in 1991. The reforms did away with the License Raj, reduced tariffs and interest rates, ended many public monopolies and allowed automatic approval of foreign direct investment in many sectors. Since then, over successive Indian governments the overall thrust of liberalization has

remained the same, although no government has tried to take on powerful lobbies such as trade unions and farmers, on contentious issues such as reforming labor laws and reducing agricultural subsidies. By the turn of the 21st century, India had progressed towards a free-market economy. The result was a substantial reduction in state control of the economy and increased financial liberalization. The liberalization of Indian economy has been accompanied by increases in life expectancy, literacy rates and food security. Thus once the ball was set rolling India has never looked back.

India enjoyed high growth rates from 2003 to 2007 with growth averaging 9% during this period. The growth rate then moderated due to the global financial crisis starting in 2008. In 2003, Goldman Sachs predicted that India's GDP in current prices would overtake France and Italy by 2020, Germany, UK and Russia by 2025 and Japan by 2035, making it the third largest economy of the world, behind the US and China. India is often seen by most economists as a rising economic superpower and is believed to play a major role in the global economy in the 21st century.

5.2 Why is India an attractive investment destination

In 2013, a global survey by a leading consulting firm, Ernest and Young (EY) ranked India as the most attractive investment destination. The major reasons cited in the report were sharp depreciation in currency and opening up of FDI in various sectors to boost investor sentiment. In addition the 2013 AT Kearney Foreign Direct Investment Confidence Index placed India as fifth most attractive FDI destination in world. The same survey had ranked India second and third in year 2012 and 2010 respectively.

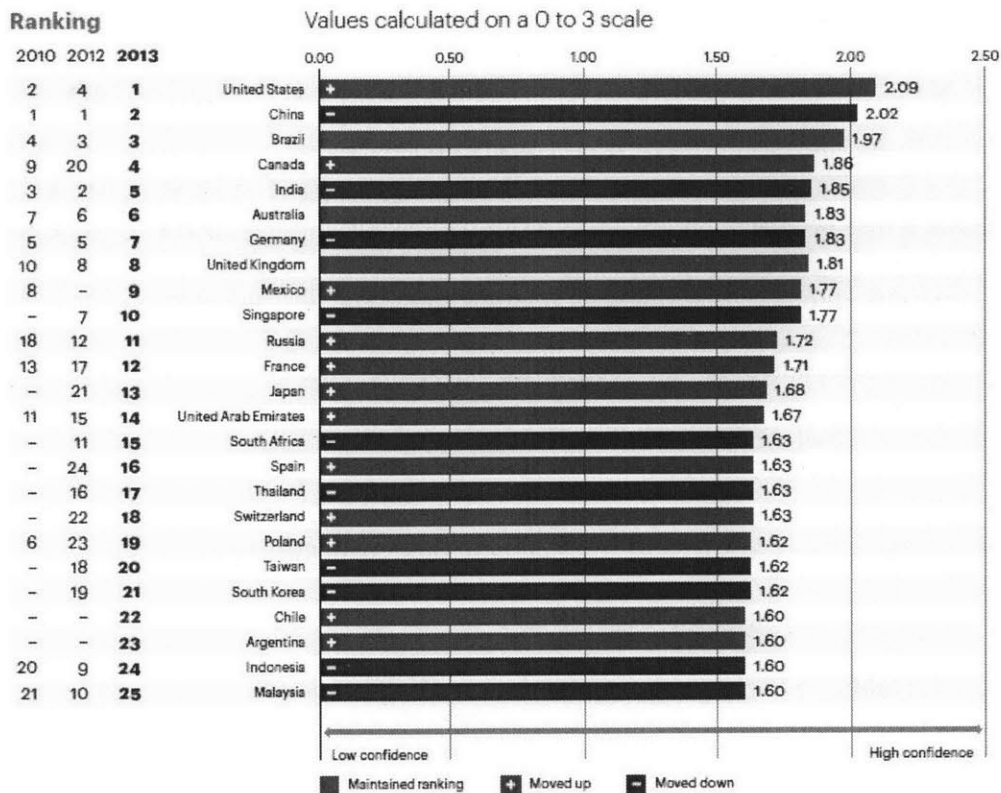


Figure 8: 2013 AT Kearney Foreign Direct Investment Confidence Index

As Indian economy continues to open up in future, I believe that there are some fundamental reasons that make India an attractive investment destination.

1. **Growing middle class:** India's force of attraction for foreign investors remains its billion strong population. The marked improvement in the living standards and spending power will cement India's emergence as an economic powerhouse. As India's economy has grown, so has the level of optimism and aspiration among its citizens. A 2007 McKinsey study noted that average household income had roughly doubled from the 1985 levels. The rise of the middle class in India is a well-known phenomenon. At the upper middle level, the number of high-income families has

more than quadrupled since 2002. Apart from an increasing middle class consumer base, a new group of low-but-rising income group is also joining the ranks of Indian consumers. PwC research shows that group will number 470 million and have an aggregate spending power of US\$1 trillion by 2021. Thus there is huge market that companies could tap and grow as a result. This new spending power is opening numerous opportunities, from education and leisure, to personal care, loans, transport, communications and travel. Most foreign firms see India as a substantial consumer market. This view is very different to that these companies have on China and other major Asian economies. These countries are seen more as manufacturing hubs which have the potential to produce products for global consumption.

2. **Demographic advantage:** According the Indian Census report in 2013, more than half of India's population was under the age of 25, with 65 percent of the population under 35. By 2020, India's average age will be just 29 years, in comparison with 37 in China and the United States, 45 in Western Europe and 48 in Japan. This demographic trend will confer a significant competitive advantage upon India. About a quarter of the global increase in the working age population (ages 15-64) between 2010 and 2040 is projected to occur in India, during which time this segment is set to rise by 5 percent to 69 percent of the total population. It is estimated that in India, roughly a million people enter the labor market every month, and this number will peak at 653 million people by 2031. As a result the IMF projects that India's demographic dividend has the potential to produce an additional 2 percent per capita GDP growth each year for the next twenty years. Therefore the young population in

India presents itself as an immense opportunity not only in terms of producing resources but also as a consumer to those resources. It is this consumption driven growth that highlights India as an attractive investment destination which foreign companies should tap in. However the key to transforming the demographic dividend into economic growth lies not just in having more people, but having large number of better trained, healthier and more productive people. The relationship here is mutually reinforcing; India must harness the advantage of its youth to fulfill its economic potential, and in turn must generate growth in order to continue to support its growing population. As noted by India's former Minister of Human Resource Development, Kapil Sibal, “it will be a dividend if we empower our young. It will be a disaster if we fail to put in place a policy and framework where they can be empowered.”

3. **Independent Judiciary System:** One major factor that takes India a step ahead of its competitors' amongst developing countries is its common law system. In corporate jurisprudence, civil and contract law, it mirrors the English legal system to such an extent that anyone familiar with western law will find the corporate law environment familiar. The essential doctrines of English law that govern their companies – for example, directors' responsibilities and fiduciary obligations, shareholder rights, powers of the board, how offences against the company are judged and how the regulator takes a view – govern Indian companies as well. Indian law is predictable. All laws, superior court judgments and proceedings are conducted in English, and not in the vernacular language. Further, the separation of power between the legislature, executive and judiciary is clearly demarcated, widely known and easily ascertainable.

Therefore the independent judiciary gives a lot of confidence to foreign investor. The confidence stems from the fact that the investors believe that their grievances and disputes would be listened to and acted upon during and after the deal cycle.

A potential obstacle posed by India's legal system is that court proceedings can be lengthy. Recent proposals to address this issue include the creation of commercial courts, i.e. a special division within the High Courts to fast-track commercial disputes that are assessed above a specified value. The implementation of this proposal may help to provide speedier resolution of large commercial disputes between companies.

4. **India is much more than a low cost destination:** In past, India was viewed simply as a low-cost center for operations, but in recent times India has developed as an active marketplace and innovation center in its own right. Indian entrepreneurs have pioneered the \$2,000 car, the ultra-cheap heart operation and some novel ways to make management more responsive to customers. These entrepreneurs are less dependent on the state patronage, are highly educated and aware of best practices to run firms and are more often than not ready to explore further. Take for example Flipkart, a company that has a similar business model to that of Amazon. The firm was created by two graduate students of the prestigious Indian Institute of Technology (IIT Delhi). Similar to Amazon the company started with selling books and soon progressed to selling a vast array of goods such as mobile phones, consumer electronics, laptops etc. The valuation of the company has reached a staggering \$1.2 billion in just 6 years. As the CEO Sachin Bansal puts it "India's e-commerce faces unique operational challenges that are very different from those faced in US. The

future success of the company will depend how we manage and overcome those challenges”. Over the years Flipkart has attracted funding from a host of VC and PE firms both Indian and foreign. Therefore India has vast entrepreneurial and management talent which is comparable to that available in any other country. This is a huge resource as the foreign investors could leverage and ensure their investments meet the return expectations of their shareholders.

5.3 M&A opportunity: Perspective of Sellers and Buyers

In the last section I discussed why India is a viable destination and a huge opportunity for foreign investment. In this section I will present reasons why M&A presents itself as an attractive route to make those investments in India. The arguments are presented from the perspective of both the buyers and sellers and will discuss the motivation of each party to be part of M&A deals in India.

Buyers Perspective: There are two main options for foreign companies that want to enter/expand and do business in India. The first is to start from scratch and setup a Greenfield operation in the country. The other is to acquire or partner with an Indian firm and thereby use that as a launch pad to expand its footprint in the country.

In India setting up a new business is a daunting task right. In its annual report “Doing Business 2014” the World Bank places India at the bottom of pile for most of the indicators it uses to rank countries in terms of setting up new business ventures in

respective country. Even after two decades of economic reforms, India continues to falter on various Ease of Doing Business sub-indices such as starting a business, dealing with construction permits, getting electricity, registering property, paying taxes, trading across border, enforcing contracts or resolving insolvency.

Its overall rank in Ease of Doing Business has dropped from 131st position in 2013 to 134th in 2014. The most glaring point to notice here is that against the key parameter of starting a business, India is worst off among the BRIC economies. It is in 179th position, while Russia is at 88th, Brazil at 123rd and China at 158th. In terms of the number of procedures and time required to start a business, India is below average among South Asian economies (eight countries). The average number of procedures for starting a business is seven among South Asian economies, it is 12 for India. The average time taken to start a business in South Asia is 16.4 days, while it is 27 days for India. An entrepreneur in India has to deal with 35 procedures to get a construction permit, while in South Asia it is less than half at 16. An SME businessman in India would take 1,420 days to enforce a contract. The South Asia average is 1,075 days.

Further taking into account the geo-political diversity where each state represents a country in itself it becomes extremely challenging for a foreign entity to start its business from scratch in India.

Therefore the other viable option to enter/expand in India is through the route of acquisitions. Though there are challenges in conducting M&A deals in India, as presented in the next section, M&A gives foreign investors a set customer base,

distribution channels, management knowhow which could be further developed to achieve the objectives of the foreign entity.

Sellers perspective: The next logical question that comes up is why would an Indian entity want to sell its business? This is a even more compelling question particularly in light of the fact that most Indian businesses are promoter owned and have taken probably many generations to build and establish the entity. I believe that there are many reasons worth considering in order to provide an answer to the above question.

The first reason is that most Indian businesses still lack the technology power to move to the next phase of expansion be it in national markets or internationally. These businesses still have a very regional focus but to build long term brands they lack the requisite technological competence. In order to get the technology not only in terms of product development but also in marketing, operations etc. they have the option to buy it from the market. However it becomes a risky proposition. This is because not only buying and installing technology is costly which could put a strain on the current business but also it is difficult to determine whether the new technology would work as per requirement.

Therefore the more realistic option is to partner with a firm that has possesses the technology and has successfully used it in past. This way the Indian entity could mitigate risk and could be on path of future growth.

The second reason why an Indian entity would be willing to sell is because it needs appropriate resources to usher the next phase of growth. The resources could be in form of capital, management knowhow, channels of distribution or knowledge about other

markets. As explained by Mr GN Bajpai (ex head of Securities and Exchange Board, SEBI) “These days more and more business are being run by third or fourth generation entrepreneurs or family members. Most of them have been educated in US or Europe and have worked there for a few years before returning to lead their family businesses. They have been exposed to best practices in governance and management and are ambitious to expand and grow their business to the next level. They are also aware of the issues that currently plague their business and are ready to partner with the right organization to grow further.” Therefore Indian businesses are looking for right partners which bring resources in terms of capital, technology, management and help these businesses build on their previous success.

5.4 Case Study: Abbott Laboratories Piramal Healthcare deal

Abbott Laboratories is an American global pharmaceuticals and health care products company. It currently has approximately 90,000 employees and operates in over 130 countries. The company is headquartered in Abbott Park, North Chicago, Illinois. The company was founded by Chicago physician Wallace Calvin Abbott in 1888. In 2010, Abbott had over \$35 billion in revenue. Abbott's core businesses focus on pharmaceuticals, medical devices and nutritional products, which have been supplemented through several notable acquisitions. For example on September 8, 2007, Abbott completed the sale of the UK manufacturing plant at Queenborough to Aesica Pharmaceuticals, a private equity-owned UK manufacturer. In February 2010, Abbott completed its \$6.2 billion (EUR 4.5 billion) acquisition of Belgium based Solvay Pharmaceuticals. These strategic acquisitions have enabled Abbott to rapidly expand its footprint across the world

Piramal Enterprises Limited, formerly known as Piramal Healthcare Limited, is the flagship company of Piramal Group. Piramal entered the pharmaceutical sector in 1988 and the company's business comprises pharma solutions, critical care, consumer products and lab-diagnostics. Piramal Healthcare contributes to over 90 percent of the company's total revenues. Piramal Group is one of the three players globally in inhalation anesthetics market. The pharma solution business unit has assets across North America, Europe and Asia. It offers services across the entire drug life cycle – from development and commercial manufacturing to off-patent supplies of API and formulations.

In May 2010 Abbott Laboratories bought Piramal Healthcare Ltd.'s branded generic-medicine unit in India for \$3.72 billion, making it the country's biggest drug maker and tapping into a market expected to more than double by 2015. The deal comprised an upfront payment of \$2.12 billion and \$400 million a year for four years. The deal has been put together in such a way that Piramal Healthcare's promoters will retain stake in the Indian company while divesting their key business. The Abbott acquisition includes the entire portfolio of about 350 generic drug brands, 5,500 employees working in the division and a manufacturing plant at Baddi in Himachal Pradesh, India. Piramal's portfolio of branded generic drugs covers multiple therapeutic areas such as antibiotics and neuroscience, besides respiratory and cardiovascular diseases.

The deal valued Piramal Healthcare's domestic formulation business, also known as the healthcare solutions business, at nine times sales at that point in time. The company's sales from this segment was \$ 400 million in the year ended March. Abbott said the deal would give it the No. 1 position in the Indian pharmaceuticals market, with a market share of about 7%. Foreign drug makers have been eyeing India for buyouts to gain direct access to India's fast-growing generics market. In November 2008, Daiichai-Sankyo (a global pharmaceutical company headquartered in Japan) acquired 63.92% stake in another leading Indian pharmaceutical company Ranbaxy for \$4.6 billion.

Emerging markets represent one of the greatest growth opportunities in healthcare, with pharmaceutical sales expected to grow at three times the rate of developed markets and account for 70% of the industry's growth over the next several years, said an Abbott

release after the deal. Abbott estimates the growth of its India pharmaceutical business with the addition of the Piramal division to approach 20% annually, with expected sales of more than \$2.5 billion by 2020. The combined Abbott and Piramal sales force will be the largest in India, said the Abbott CEO, adding that the price that it paid for the Indian business was just right. On the other hand giving his reaction to the deal Piramal Chairman Ajay Piramal reasoned “I don’t think we were in a position to take it global. A company like Abbott has the strength and aspirations to do that. There aren’t too many markets growing at 25 percent annually and it’s a good opportunity”

Wharton management professor Saikat Chaudhuri while presenting his analysis said that the relatively higher valuation makes sense for Abbott. “Sure, it is on the higher side, but we are also talking about a lot of potential in these markets and multiple synergies,” he says. “There are revenue synergies; the reach of generic drugs could be expanded globally, and Piramal’s sales and distribution network can be used to more effectively market drugs that are developed elsewhere. On top of that, India is a growing market.”

After the acquisition Abbott group has made India an exclusive business region, reporting directly to the headquarters of its established pharmaceuticals business in Basel. The US parent has also appointed a new country Bhaskar Iyer to oversee its three existing pharma units in the country. The major responsibility given to Mr. Iyer was to explore synergies between the acquired and the present business as well as other with areas such as nutrition, diagnostics and medical devices that it operates within the group.

“India plays a very important role in Abbott’s established pharmaceuticals or branded generics business in the emerging markets,” Iyer said in an interview post his

appointment. “We want to enhance India’s contribution further by substantially accelerating growth in the next four years. Our new strategy will involve increasing visibility of many of our legacy brands both from Piramal as well Abbott portfolios by investing in people and operations. Our aim is to come up with new brands by strengthening the development efforts at its Indian research facility and penetrating into newer markets both in terms of geographies and therapies.

6 CHALLENGES OF DOING M&A IN INDIA

In this section I would discuss the challenges faced by international companies while doing M&A activity in India. This section encompasses challenges a company might face both during the various stages of deal cycle and due to regulatory obligations imposed by various Indian agencies. I have presented two case studies to discuss the above issues. The first case study is about the joint venture between Unitech and Telenor. The case discusses the issues Telenor faced during its association with the Indian partner. The second case study presents the Vodafone tax issue and explains in detail the taxation and other regulatory consideration a company needs to be aware of during the deal process.

6.1 Challenges during Deal Cycle

This section discusses potential difficulties a foreign company encounter during its M&A activity with Indian counterparts during the various stages of deal cycle i.e. target identification, due diligence and valuation, deal negotiation and post merger integration.

Target identification: The first step in acquiring a company is to source a suitable target in terms of geography, sector and company. India as a market presents an interesting and complex proposition because of its size, its socio political diversity and regulatory structure. This presents a difficult prospect for a foreign firm to identify a suitable target. One issue that is often a key concern for the foreign entity is that there is a wide gap between an Indian target's attitude towards compliance and governance and the international acquirer's expectation. Most Indian businesses are owned by promoter family which has significant say in the governance of the company. With no distinct

separation between ownership and management, the company is run very much in accordance to the wishes of the promoter. Further the issue of corporate governance could impact the acquiring firms in their home country. This is particularly true in light of the recent UK bribery act and US Foreign corrupt practices Act that was passed in UK and USA respectively. A case in this perspective is the failed joint venture between Bharti and Wal-Mart and subsequent issues Wal-Mart had to face in its home country. Therefore this greatly reduces the large available targets to a few viable targets for the foreign entity in India.

Another challenge many acquirer firms face while sourcing for a suitable target is that there are very few firms that have an outreach pan India. Although there are firms with strong regional presence, these firms have mostly struggled to expand due to lack of management or capital and thus have remained regional players. Often such firms fail to meet the international screening criteria and therefore acquirers are left with few targets to work with.

Due-diligence and Valuation: In last decade India has emerged as an attractive M&A destination. Consequently the capital chasing the transactions has often outstripped the number of viable companies for sale. This has intensified competition thus driving up valuation expectations of Indian companies as they are aware of acute competition for their businesses. One of the most challenging aspects of doing deal in India is arriving at the right valuation for the company that is acceptable to both the acquirer and the target company.

The first major challenge for the acquirer is to get the financial statements that are accurate and exhaustive. Unlisted or private companies in India are not required to disclose their financial statements and are not subjected to regular audits done by reputed audit firms. Even for the listed firms the disclosure requirements are much lower than those in the developed markets making it extremely difficult to rely on secondary research for valuation purposes.

The situation is further complicated because a lack of credible historical data makes it difficult for getting base values for future forecasting purposes, particularly during the preparation of business plans. For example in family owned businesses it usually happens that business contract terms with vendors or customers sometimes tend to be relationship based and agreed verbally, making the guarantee of a future commitment unclear to a acquirer. Therefore it becomes difficult to determine the reliability of the true values of receivables and payables as presented by the target firm. There remains a huge question as to whether the commitment would remain valid once the deal gets completed and the owner moves out of the business. Therefore issues such as these hamper the ability of the acquirer to nail a credible business plan for the target firm and arrive at a valuation figure. In general the lack of full transparency makes it extremely difficult for the acquirer to determine the true nature of assets and liabilities he would own post the deal activity.

The second issue is how to come up with an appropriate value for the deal that meets the expectations of the Indian target? Since a larger number of businesses are owned by families, their motivation for selling a business is generally more complex and varied than that of a business run and managed by an independent management team.

Furthermore, valuation expectations of the owners are generated by Indian equity markets,

which historically have commanded a higher premium compared to global peers especially the BRIC nations. As explained by a senior JP Morgan M&A manager who has been involved in a number of such deals “Usually the promoter has a range or even a number in mind. This number is either the highest bid he has received in past for his business or the valuation of his business when the equity markets were all time high. He usually does not consider that there might have been erosion of his business value since that time or there needs to be an adjustment made due to change in business cycle. Therefore when the markets are down and when most acquirers would be interested in doing business we normally see not much M&A activity in India .The owner still believes that the price must be in range of his earlier estimates. Thus as observed in Indian context, most deals get completed when the markets are at peak and not the other way round. There is some sort of euphoria present which really drives up valuations and more often than not these deals are not as profitable for the acquirers.”

Another point to consider is that given the relatively short M&A history there is a lack of availability of reliable deal information and therefore comparable multiples can be difficult to determine. This is particularly applicable in cases where deals are being done for the first or second time in a sector in India. In absence of such information it becomes difficult to arrive at base valuation and the average premium that was paid earlier which could be used as reference for future valuations and negotiations.

Deal Negotiation and post deal Integration: According to Mergermarket, differing approaches to deal timelines have been known to impede M&A in India. The common perception is that many Indian companies do not follow agreed upon timelines for deal

milestones, often resulting in "two steps forward, one step back" scenarios. Moreover in situations where the timeline is not adhered to, it often happens that the value of deal might change due to external circumstances and the entire deal negotiation might start from step one.

Another issue to consider and usually is key focus during negotiation is what role the promoter family would get in the new entity? Though much of it depends upon the percentage of stake the acquirer is getting in the deal. As explained earlier, the promoter usually in past might have used personal relationships to manage vendor and customer relationships. It is therefore imperative to see the extent of these relationships. Further it should not happen that once the promoter is out of the business the relationships and favorable prices leave with him. Therefore the acquirer is faced with tough act of balancing the role of promoter post merger. On one hand the promoter might provide with his management insight based on his experience to the new entity as he is more educated in local issues. On the flip side his presence might act as a deterrent for the new firm to realize the proposed synergies due to his influence on the firm's operations. Although there is an unwritten rule that once acquired the promoter usually does not set up a competing business. But sometimes it has been seen that the promoter when out sets up a business quite similar to his previous one because it is the only thing he excels at. Thus it becomes imperative to come up with clear expectations of the promoter's role during deal negotiation phase.

Another aspect of post merger integration is to address the management and cultural differences amongst the two firms. There are a number of issues related to management

of the new entity that needs to be addressed during the integration phase such as transparency, accountability and attitudes towards compliance. There are also issues related to management style, and more specifically, the empowerment of employees in the new firm after the merger.

The other daunting task organizations face during an acquisition is alignment of people and culture. The cultural differences between the two organizations need to be managed and addressed. This is even more relevant in Indian context because of the cultural diversity present in India itself. Therefore this dimension becomes even more critical as the acquirer is now dealing not only with organizational culture but also with the culture of two different nations. It is important that the cultural differences are mapped and plans need to be drawn up to manage the difference. Even identifying the differences can be a huge enabler for future success.

6.2 Case Study: Unitech Telenor Joint venture

Unitech Wireless until 2009 was a subsidiary of Unitech Group, holding a wireless services license for all 22 Indian telecom circles since 2008. Unitech Group was primarily a real estate property developer in India and had limited experience in the telecom sector. But nevertheless it had bid for and won spectrum licenses in 2008 and was therefore looking to move in the attractive telecom space in India. In early 2009, Unitech Group and Telenor Group (a telecommunications company headquartered in Oslo, Norway) agreed to enter a joint venture where Telenor would inject fresh equity investments of \$ 1.2 billion into Unitech Wireless to take a majority stake in the company, Unitech wireless. Telenor saw India's telecom industry an attractive proposition in terms of growth potential and needed a partner if it wanted to offer telecom services in India. This was due to the fact that Indian law time that at allowed a maximum 74% foreign holding in telecom services, thereby making it imperative for any new foreign player to partner with Indian entity to enter India. Since Unitech had won the spectrum licenses, a joint venture made sense as Telenor could use its technologic and management expertise to develop those licenses. Therefore Unitech Group which had bought the licenses for around \$ 33 million from the Indian government sold the licenses to Telenor at almost six times the price.

One of the tenets of the deal was that the amount paid by Telenor to Unitech would be used as operating capital invested directly in Unitech Wireless. Telenor Group conducted these investments in four tranches, subsequent to approvals from the Foreign Investment Promotion Board (FIPB) and the Cabinet Committee of Economic Affairs (CCEA) and took 67.25% ownership of Unitech Wireless. In September 2009, the company

announced its brand name as Uninor. Telenor has acquired all stakes from Unitech and its shareholding in the firm stands at 74%.

After the deal, Uninor launched its services in 8 circles on 3 December 2009, thereby completing one of the world's largest GSM Greenfield launches. The project was also one of the fastest telecom roll-outs ever in India. According to Uninor, the brand was built around an ambition to serve the young, aspiring India. Six months later, 5 additional circles were launched including metropolitan areas like Mumbai and Kolkata. Uninor facilitated rapid scaling of the company through a lean operation model, where a large share of the network infrastructure is outsourced to business partners. Uninor's modern equipment enabled it to introduce targeted offerings and serve a large audience with limited spectrum. Uninor introduced dynamic pricing, a concept that gives consumers discounts that are based on current network traffic at an individual site and change with location and time. Over the summer of 2010, the company further simplified its strategy with a focus on three core areas – excellence in mass market distribution, basic services and cost efficient operations. Changes were also made to the product mix and marketing communication – making them simpler, more direct and clearly, positioning Uninor as an affordable mass market service. Uninor grew from 0 to 45.6 million customers (as of Q2 2012) within less than two years, and the combined entity emerged as the most successful of the new entrants that obtained licenses in 2008. Further it employed more than 150,000 employees as it delivered its services over half the Indian sub-continent. The company had more than double the subscribers of all of the other entrants combined. Therefore at this stage everything was going as per plan and the merger was able to realize its intended synergies.

But the relationship took an unexpected turn when in 2011 the government of India found irregularities in the spectrum allocation process. Unitech Group was particularly found to have involved in irregularities of the process of obtaining telecom licenses. On 2 February 2012, the Supreme Court of India cancelled 122 licenses of 22 mobile operators, including Uninor. The Supreme Court directed the Government of India to conduct fresh auctions for sale of the spectrum within a period of four months, asking TRAI to come up with fresh recommendations. As the then CEO Jon Fredrick remarked “The ruling is a very serious attack on our investments, which are based on the license framework that was spelt out in 2008. We met every inch of regulation of that license. We have brought competition to the Indian market and view the ruling has retroactive consequences.”

According to a Harvard Business Review article “It is interesting to note that even before the Supreme Court’s judgment about licensing irregularities; the partners were struggling to give clear direction to the partnership. The two firms had faced strong debates about changes to investment responsibilities, geographic strategy, target markets, pricing strategy, relationships with infrastructure providers, and many other key elements of the business model.”

The capability gap between the two firms was simply too great for a joint venture to work. Given Unitech’s limited experience in mobile telephony, Telenor staff needed first hand engagement with the Indian firm’s personnel in a wide-ranging set of activities: negotiating refinements to the telecom licenses, creating technical and marketing organizations, creating relationships with infrastructure partners, developing and

adjusting a marketing and pricing strategy, and building a management team. This level of engagement placed too many stresses on the Uninor partners. Further a key question to consider is that whether Telenor could have foreseen such an event or a process by which it could have determined the quality of the licenses. One could argue that Telenor's process of due diligence is highly questionable considering that the Comptroller and Auditor General of India's report on 2G spectrum allocation of 2010 revealed that all 22 license applications submitted by Unitech were an attempt to “fraudulently access spectrum” by submitting defective and false documentation.

On its part, the Telenor group maintains that it did indeed conduct its requisite due diligence on licenses which were processed, scrutinized, stamped and guaranteed by the Indian Government under the same policy that had been established for years. It is hard to believe that Telenor, as a large investor, was unable to locate these flaws, despite its due diligence being restricted to examination of these basic documents alone.

Unitech was at fault too, not disclosing enough about the way they acquired those licenses. There is very little doubt that Unitech conspired and used fraudulent practices to acquire those licenses but the question here still remain that was it possible to identify those before the deal was struck. The HBR article concludes “On the basis of facts, joint venture was deemed to be a failure from the start- one firm with limited experience in India and the other with limited experience in telecom, requiring both partners to attempt to cover too much ground.”

6.3 Regulatory Challenges for M&A in India

As India becomes a mainstay of the global corporate climate, the legal environment in India is increasingly becoming more sophisticated and refined. Today, M&A in India is a vital part of inbound and outbound economic activity. However, the regulatory procedures are still playing catch up to the new scenarios that are emerging in the M&A landscape in India. Further as companies and government decipher the complexity currently present in the current legal system and find ways to tackle those uncertainties in the best possible manner, there is constant evolution in the regulatory framework. In the below analysis I present certain key characteristics that are impacting the growth of M&A in India and factors that acquirers need to take into consideration while doing deals in India.

Regulatory Uncertainty: M&A laws in India are still evolving and the regulators are still catching up with the global M&A wave into India. This effort to ‘catch up’ however often results in the regulators applying varying interpretations of a stated law which has created substantial confusion and an upheaval of settled market practice. One such example is the definition of “Control”. The definition though consistent across various laws is still subject to the interpretations of various regulators. Multiple regulators interpreting the same definition has definitely resulted in increased confusion in the minds of foreign investors. This definitely impacts deal certainty and resolving this issue is definitely a must if the Indian government expects to attract greater foreign investment into the country.

Regulatory Development: Further, the core tenets of Indian law, especially those involved in M&A transactions, are in the process of undergoing modernization. Currently there are more than 116 major bills that are pending parliamentary approval. Such major bills include Goods and Service tax and the Direct Tax Code as well as financial sector reforms on pension funds, banking and insurance. The GAAR regime is yet to be implemented. Once these legislations are implemented, these new statutes will help bring India's outdated laws into the 21st century and hopefully smoothen the lifecycle of an M&A deal in India. But till then the acquirer firm need to study and be prepared to deal in the existing framework of laws that are present. The implication of how the situation might change post deal need to be kept in mind and progress be made accordingly.

New Legal Developments: The introduction of the Competition Act, 2002 and the revamped SEBI Takeover Regulations in 2011, as well as the notification of limited sections of the new Companies Act, 2013, has created their own sets of issues in India particularly related to their interpretations and impact on deal timelines, valuations and processes. The SEBI Takeover Regulations in 2011 have changed life for Indian listed companies and for their shareholders, Indian and global. The 2011 Code has been extolled for simplifying the open offer and disclosure regimes in India, while incorporating global best practices. However, the Indian industry continues to grapple with issues such as negative control and the regulator's unpredictable interpretations of the regulations.

The notification of the new Companies Act, 2013 has certainly been a game changer for

corporate India. However whether this new act will overhaul, modernize, and simplify corporate laws in India or just remain an “old wine in a new bottle” definitely needs to be seen in future. The recent SEBI and RBI notifications on call and put options have provided some perspective in the manner in which regulators will treat option arrangements in Indian contracts. However, the notification does not have a retrospective effect and one needs to see how the Indian regulator will treat existing option arrangements.

Going private continues to remain a missed opportunity. Price discovery driven by participating shareholders has often led to the failure of delisting offers, since anticipated loss of liquidity drives up delisting price. Even if company is successfully delisted, minority squeeze out is still not permitted in India. This creates difficulties in effective consolidation. Additionally this may give a small number of shareholders greater say in decision making (where related party transactions have to be undertaken) and in cases where the promoter holds 90% or more, minority shareholders have a perpetual put right against controlling shareholder under the new Companies Act, 2013. However SEBI is cognizant of concerns surrounding delisting and proposes to revamp the existing delisting regulations.

Shareholder Activism: Institutional investors in the minority position in multiple listed companies are becoming more proactive in monitoring investee companies. Proxy advisory firms are also playing an important role and their significance has increased in checking promoter driven transactions. They closely scrutinize related party transactions,

appointment of auditors and directors and executive remuneration. The role of the minority shareholders in Indian listed companies has also significantly increased. In certain cases, the approval of the “majority of minority” shareholders is required. The new Companies Act, 2013 has also granted greater powers to the minority shareholders including the right to bring a class action suit against the company, directors, third party advisors, to sue against oppression and mismanagement, to exercise their put right against controlling shareholders and to exit in certain specified circumstances.

6.4 Case Study: VODAFONE TAX CASE

The Vodafone tax controversy is one of the most high profile and most talked about tax disputes in India so far. The case has gained significant attention globally from investors, administrators as well as scholars and has wide implications for future M&A in India.

In 2007, Vodafone (world's second largest telecommunication company headquartered in London) acquired the stake of Hong Kong-based Hutchison Group in Hutchison Essar's telecom business in India. The Hutchison Essar was a joint venture and had over the decade built a significant presence in the telecom space in India under the brand name "Hutch". Now as envisaged by Vodafone and Hutchison, the deal was an offshore acquisition where Vodafone Netherlands acquired ownership of a Cayman Island based entity called CGP Investments from a Hutch group entity also based in Cayman Island. So, theoretically it was a pure offshore transaction between two non-resident entities (Vodafone and Hutchison) and they bought and sold shares of another non-resident entity (CGP).

However the Indian tax authorities took a position that by virtue of such an offshore deal effectively the two parties have really sold stake in the Indian telecom business of Hutchison Essar. Therefore, the authorities argued that profits realized from the indirect transfer of an Indian asset (telecom business in India) was taxable in the country and the buyer should have deducted applicable withholding tax while making payment of the purchase price of this business. In the same year the tax authorities issued a show-cause notice to Vodafone, asking why it should not be treated as a defaulter for not deducting Indian withholding tax while making payments to Hutch as this offshore transaction

effectively resulted in transfer of an Indian asset and hence liable to capital gains tax in India.

The show-cause notice was challenged by Vodafone in a Writ Petition (WP) before the Bombay High Court (HC) which was dismissed in December 2008. The HC observed that prima facie Hutch had earned taxable capital gains in India as the income was earned from transfer of its business/ economic interest in the Indian company. The HC also took serious note of the fact that Vodafone did not produce some of the critical transaction documents which could have been instrumental in determining taxability of the transaction in India. The apex court finally did not uphold such a claim emphasizing that the relevant law did not cover such an offshore transaction within its tax net in India and that certainty in tax laws is of paramount importance for foreign investors as well as for Indian residents.

Further Vodafone filed a Special Leave Petition (SLP) before the Supreme Court (SC) of India (highest judiciary body in India). This SLP was dismissed and the SC directed the tax authorities to decide whether they had jurisdiction to proceed against Vodafone in the matter. However, the SC permitted Vodafone to challenge the decision of the tax authorities directly before the High Court (HC) rather than first going through the normal channels of Commissioner (Appeals) and the Income Tax Appellate Tribunal. In May 2010, the tax authorities passed an order taking the view that they had jurisdiction to proceed against Vodafone and accordingly treated the company as an 'assessee in default' for not withholding tax from payments made to Hutch even though it was an offshore deal between two non-resident parties.

Thereafter Vodafone challenged this order of the tax authorities before the High Court. The High Court dismissed the case and ruled that the tax authorities indeed had jurisdiction to proceed against Vodafone as the income (capital gain) did accrue / arise in India by virtue of transfer of assets situated in India. Aggrieved by the order of the High Court, Vodafone approached the Supreme Court.

On 20 January 2012, the SC pronounced its ruling in favor of Vodafone holding that the transaction was not taxable in India and thus the company was not liable to withhold tax in India. The real turning point of the whole issue came in when the Indian Government passed Finance Act, 2012 which amended Income Tax Act retrospectively to bring offshore indirect transfer of Indian assets (Vodafone like transactions) within the Indian tax net. This triggered lot of criticism from the investor community globally. This has created significant uncertainty and has perhaps made the investor community wary of investing in India.

Sensing the trouble and to allay fears of investors, the Prime Minister of India constituted an expert committee to review these retrospective amendments and to recommend changes to the government. The committee submitted its report in October 2012 to the government and since then there is no clarification or amendment as regards this provision.

The case provides an insight how Indian laws might change even after the deal. As explained since the laws are not fully developed the interpretations can be quite different by different institutions involved. Therefore it becomes all the more important to understand the current regulatory framework present and plan and execute the deal

accordingly. Moreover the Indian government should on its part take each deal as a learning point and evolve its laws to boost the investor sentiment. The retroactive actions on prior deals will create more uncertainty for the investor community and as a consequence reduce big ticket acquisitions in India.

7 RECOMMENDATIONS

In this chapter I would present my recommendations in terms of best practices acquirers can undertake while conducting M&A in India. The results presented below are arrived primarily through secondary research and by conducting interviews with industry experts who have been part of such M&A activity either directly in advisory capacity or observed and monitored such deals as regulators.

Develop relationship with promoter family: The promoters view their business not only from financial aspect but also from emotion point of view. They generally view the business as a family legacy one which has been built by generations of hard work. Therefore they attach a significant emotional premium to the thought of selling it. For international companies getting to know the promoter and the family is the first step towards successful outcome of the deal. The strong relationships built over time will prevent the pitfalls of reluctant bidders and high valuations. Moreover it is imperative to keep all decision makers in the family on the same page regarding the progress of the deal. Investing in these relationships early pays off when the deal is being negotiated later. However, all this takes a considerable amount of time. Therefore, buyers should prepare to be patient and plan accordingly.

According to Mr. GN Bajpai ex SEBI (Securities and Exchange Board of India) Head and currently on board of two large family owned businesses in India “ The second and third generation heads of family owned businesses are much more open to work with a strategic partners if it best for their business. Most of these CEO’s are educated in western countries and are aware of international best practices in terms of corporate

governance, disclosure norms and are prepared to work with an outside entity to propel their organization towards greater heights. Therefore international firms should find such business heads more amicable to work with.”

Prepare a comprehensive entry plan: The first thing to identify is what sector or industry one wants to enter. In India each industry sector has different FDI limits and there are different ways a foreign entity could conduct business in India. For example in retail, the maximum allowable FDI limit is 100% for single brand and 49% for multi-brand retail. Both these scenarios present a totally different proposition how the company would want to conduct its M&A activity.

The second consideration is the type of company the foreign entity wants to acquire or partner with. In each sector there are a few well established names and others which are emerging and have huge potential. According to Mr. Bajpai “The best thing to do is to find such growing and emerging players in the sector and try to gain full control. This way the foreign entity has a higher probability of realizing the intended synergies.” In his view acquiring minority stake in large well established firms is more suited for private equity where the sole intention is to exit in a few years time when the valuations are high.

Remain Flexible on Deal Structure: A key question that would be usually asked by the promoter trying to protect his interest would be “What is there for me and my family post deal completion.” They are usually interested in some sort of operational or strategic role which can be diminished as time progresses. The best way to navigate this issue and win

trust is to keep promoters stake either in minority or majority capacity for some time. When the target business is attractive over the long-term but short-term execution challenges remain, an acquisition in stages is the best method. It is advisable to use call options to increase ownership gradually and earn-outs when promoter involvement is needed for a transition period. This will give time for the foreign entity to understand the business and develop communication channels with vendors and customers. Then gradually as the acquirer becomes comfortable with the settings he can increase its shareholding in the firm based on an agreed roadmap which should be the part of sale purchase agreement to avoid problems later.

Cultural integration starts on day one: The acquirer needs to perform a cultural gap assessment and have clear training plans in place for employees to bring them up to speed on what it means to operate and be successful in an international company environment. One should be sensitive to cultural differences, but be clear on the behaviors that will be rewarded in the combined organization; otherwise decision making will suffer and cause frustration. Communication is probably the most important tool during the integration period. Poor communication can lead to anxious customers, de-motivated employees, uncooperative suppliers and demanding shareholders. Each stakeholder's requirement needs to be understood and managed through adequate and timely communication. Organizations need to create an effective communication strategy that addresses each stakeholder by understanding their needs. This will prevent non issues from becoming issues.

Know where to look and expect to find problems: Finding issues with compliance, tax or historical financial performance is common during due diligence and can seem like a deal breaker at first. The acquirer needs to take the time to understand the associated liabilities and also the impact of significantly changing the target company's business practices. There may be an inverse relationship between establishing compliance measures post-acquisition and short-term growth. The acquirer should build a business forecast bottom up whenever possible and seek independent verification of future contract commitments and promoter relationships for business continuity. Further the acquirers could use transaction structures that leave the liabilities behind and ensure sufficient engagement from promoters to guarantee a smooth transition post deal. In order to ensure that the deal does not face post acquisitions issues such as such as tax demands, non-compliance penalties, customer or employee claims, inventory issues and non-budgeted capital expenditures it is best to insure oneself by mentioning such contingencies in the deal document and appropriate actions in case of such unforeseen emergencies.

Run the integration as a distinct project with a dedicated team: The foreign entity needs to clearly document the purpose of the transaction, the vision for the integrated business and the degree of integration expected. Before the deal closes, ensure alignment regarding this vision with the target management to prevent confusion later. One needs to establish key factors one will use to measure the success of the integration and build this into management goals. Manage the integration with a small team comprising people from both the acquiring organization and the target company, and let the rest of the business manage day-to-day operations.

The deal process in India can seem long and often seems unending. One should expect for delays during and after the deal cycle and should plan accordingly. These days all major global investment banks and advisory firms have their presence in India. Further Indian banks have also developed investment banking capabilities. Hiring advisors can help, but the company has to accept the fact that dealing with regulatory authorities will take time and will add more uncertainty to the process. Time invested in knowing the seller and building a relationship plays an important role during this period, as negotiations can be complex, patience is the key for achieving success in Indian M&A market.

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