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International Expansion Activities of Indian Multinationals: an Analysis of Market Reaction to Internationalmergers and Acquisitions

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ABSTRACT

This study investigates the Internationalization strategies of Indian Multinationals. Hence, it scrutinizes the value implications of Indian Multinationals (IMs)). This study examines 763 mergers and acquisitions (M&A) announcement of 93IMs during the sample period of 2000-2012. When value creation is considered, the paper explores the effects of cross-border expansion patterns on firm value creation. Then, it examines market reaction to the announcements of cross-border expansion patterns. Finally, it evaluates firm performance in relation to the cross-border expansion activities. This study finds that most IMs earn positive abnormal returns during the event windows defined in this study. Hence, it is generally evident that there is value creation in international expansion activities of IMs.

KEYWORDS : Firms from the Eastern Europe; International Investments, Foreign Direct Investment; Cross-border Mergers and Acquisitions; Emerging Market Multinationals; Internationalization; Event Study

I- Introduction

This study examines the valuation effects of cross-border expansion patterns of a distinct group of firms - Emerging Market Multinationals that originate from the emerging markets (EMs) of India. The study commits its analytical foci on Mergers and Acquisitions (M&As), given that Indian Multinationals (IMs) achieved to build multinational service and production networks akin to their developed country counterparts by internationalizing their operations through regional or global configurations with the utilization of these three specific types of expansion patterns. IMs diffusion in to the global economic system signals formation of relatively complex organizational structures with potentially distinct characteristics. As a result of their dynamic international activities, these new players with regional and global focus have become a significant mechanism for the transfer of capital, technology, management and various other assets within and between developing and developed countries, and created new engines of growth in emerging markets.

The cross-border expansion patterns of IMs, which initially began or came to be recognized in the late 1970s, were launched with exporting activities. These activities are constantly evolving and stimulating modification in the way IMs conduct their business operations. Although IMs have been going through varying levels of transformation for several decades, their renowned transformation gained pace since the early 1990s in the face of intensified integration of their home markets to the world economy, which was inaugurated with the beginning of the new era of globalization. Owing mostly to their home market integration to the global market, domestic companies located in these markets adopted increasingly outward oriented postures and included M&As, JVs, and SAs into their global operations as opposed to focusing solely on export activities. It was inevitable for them to diversify their expansion strategies since they either had to take advantage of regional or global business opportunities or needed to respond to increasing competition from foreign companies. However, despite their growing regional and global importance, our knowledge of various attributes of these firms is limited and most work conducted in this area gives conflicting results on value creation effects of cross-border expansion activities of IMs. Therefore, the primary objective of this study is to examine the valuation effects of IMs' cross-border expansion patterns. Therefore, the research problem can be presented in the form of a question: Do cross-border expansion activities that involve M&As, create value for IMs?

This study includes a sample size of 93 Indian Multinational firm, mostly drawn from the *Top 50 non-financial Emerging Market Transnational Corporations*. UNCTAD's World Investment Report. The internationalization events take place between 2000 and 2012. These transaction announcements entail 763 mergers and acquisitions. In this study event-study methodology is utilized to capture the market reaction to expansion announcements as well as to examine the impact of each announcement on the firm value around the announcement date.

The paper is structured as follows: Part II focuses on the methodological literature reviewbased on value creation, and M&A activities in cross-border expansion patterns. The reminder of the study is organized as follows: Part III discusses the data and methodology; Part IV presents the empirical results; and Part V concludes the study with final remarks and discussion.

Part II -Methodological Literature Review

The concept of the international operations of firms from developing nations (most are now identified as emerging market nations) is not a novel phenomenon. The first recognizable emerging market firm operations dates all the way back to the pre-World War I period. However, this was only actualized within the Latin American region. Although, some Latin American firms experienced international expansion in the 1920s, it was too little to account for. In fact, expansion activities of firms from the developing economies began in the 1960s and increased vigorously during the 1970s. The time lag was mainly due to the restrictive government policies of the 1930s - 1960s. Government restrictions, mainly exchange controls and inward-looking foreign trade policies of Indian Government hamperedIMs for geographically wide-scale expansion. For this reason, the expansion activities of the IMs stayed only within the region.

When the expansions began to increase and spread to outside of the region in the 1960s and the 1970s, they were mainly executed by private investors that historically invested in liquid form or in real estate, purchasing available stocks and securities. Furthermore, some investments can also be characterized as *capital flight* rather than as FDI. In the late 1970s, however, the decisions to expand were induced by cultural, political pressures and instability. Such factors as risk diversification in unstable political systems, avoidance of domestic tax obligations, labor laws, and foreign exchange restrictions also provoked IMs to internationalize. In later years (1980s and 1990s), changes in government policies, the economic growth within various developing countries, the improvement of their balance of payments, and implementation of interregional programs as well as the consequence of IMs.

In the early years of IM expansion, geographic preference mostly depended on host countries' geographic proximity, and ethnic/cultural closeness to their home countries. However, in recent years, the strategic significance of geographical location, geographic reach, as well as transnationality rather than cultural/ethnic ties came to be more important in making expansion decisions. While in the early stages of international expansion, IM activities were mainly based more on labor intensive, low cost and technologically small-scale manufacturing operations, in recent years, their operations and technological adaptations have begun to display a more innovative outlook, which are more in line with rapid technological and industrial changes.

These changes also triggered changes in the modes of international expansions of IMs. In the early years of expansions, exports were favored for international operations. They carried out trade-related export strategies and/or export led growth strategies and thereby established export businesses as incremental commitments throughout the 1980s. In the early 1990s, however, joint ventures and strategic alliances began to dominate the expansion seen. Besides these activities, the operations of IMs have come to include, cooperative arrangements, strategic alliances, firm networks, and M&A activities. Although M&A activities have minimally been experienced since the mid-80s, in recent years, they have become more apparent. Today, M&A activities are becoming popular strategic tools for IMs looking to expand their market reach or to develop new sources of material. In addition, the accumulation of ownership advantages is motivating and increasing M&A activities of IMs. Due to these changes, IMs are also modifying their internal operations at intra- and inter-firm levels in a wider geographic access and focusing on efficient use of capital and resource as well as to their geographical reach.

Yet, IMs face a set of transaction costs, risks and opportunities more than they previously experienced. They also confront such issues as geographic dispersal of assets and liabilities across the globe and access to capital markets of different locations with variable exchange rates and differing regulations in further intensity. Hence, an understanding of the cross-border expansion patterns is one key to understanding the impact of IMs on international business and a channel in understanding IM value creation.

Transaction Cost Economics and internalization perspectives in international business literature suggest that firms extract above normal returns from cross border investments by internalizing market imperfections when their firm specific assets cannot be sold for their internal value due to market imperfections. Therefore, rents derived from internalization are expected to be capitalized into a higher value of the firm. Consequently, when IMs first initialized their international expansion activities as manufacturing firms, they gained their initial advantage through internalizing market imperfections.

Similarly, Market Structure Approach - The Industrial Organization Approach states that multinational firms are organizations of international production rather than international capital movement. Here, ownership advantages are seen as a *net cost advantage* of foreign owned firms in local markets. In order for a firm to invest abroad, it should have specific advantages to compensate for the advantages of local firms. Hence, firm specific advantages may be due to such reasons as market imperfection caused by product differentiation and marketing skills, imperfections in factor markets, economies of scale, and government intervention in the marketplace.To obtain these advantages, however, the production needs to be home-based; in this way value creation may be attained.

Hymer's theory can also explain some of the reasons for cross-border expansion and for their existence in the international frontier. In the early years, Indian firms gained special assets through horizontal investments. This was mainly as a result of knowledge accumulation. In this way, firms adapted foreign technology to a specific small-scale operation and applied it to new markets at low marginal costs. This emerged as a necessary condition for the firms' cross-border expansion activities and value creation.

In most cases, however, the decision for international expansion is determined by ownership, internalization, and locational advantages, which are available to the IMs. This has especially been the case in recent years. Dunnning's (1981) macro level study on Indian firms indicates that the net outward investment from these countries increased over time. Dunning ascribes this increase to the rising ownership advantages. Hence, IMs gained ownership advantages in two perspectives: the technologies they utilized for FDI were more labor intensive and appropriate for host countries; and they developed production processes as their factor endowments. Therefore, for IMs ownership advantages and value creation arise from making technologies adaptable to smaller market sizes and factor endowments of other developing countries.Overall, the existence of ownership advantages suggests that value creation had to exist for firms to expand abroad in the past.

The Multinational Network Hypothesisis one of the contemporaneous theories that can explain IM activities since IMs began to exploit M&A, JV and SA patterns for their cross-border expansion activities in more recent years. The hypothesis postulates that foreign investment decisions improve the expanding firm's ability to benefit from the systemic advantages inherent in a multinational network.The valuation effects of strategic actions leading to creation of a multinational network stem from the firm's ability to arbitrage institutional, and the informational externalities captured by the firm. The cost savings gained by economies of scale in production, marketing and finance also have a role – to the extent that these options can be exercised by the acquiring firm and cannot be traded and acquired by other investors because the value of the firm should increase to reflect the incremental value of these options.

However, it should also be realized that cross-border investments of Indian firms did not necessarily emerge as a deliberate effort to promote joint ventures or other types of FDI. Not all Emerging Market cross-border activities fall in clear categories.

As it can be observed from previous studies, mergers and acquisitions, joint ventures and strategic alliances are strategic tools for firms operating in international markets. They are also a growing phenomenon in cross-border expansion activities of IMs with which firms respond to globalization of various industries and a rapidly changing international business environment.

Part III - Data and Methodology

IM sample data are obtained from the United Nations' UNCTAD world investment report on transnational corporations and export competitiveness. Merger and acquisition as well as joint ventures transactions data for 2000-2012 are extracted from the Securities and Data Corporation's (SDC) Worldwide Mergers and Acquisitions database.

Here, the standard event study methodology is utilized to evaluate the impact of each expansion announcement on the firm value. The event-study methodology is inspired by the efficient market hypothesis that capital markets are efficient instruments to evaluate and process the impact of new information available on firms. The market model assumes a linear relationship between the return of any security and the return of the market portfolio. For each security i market model assumes that returns are given by:

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{t},$$

where,

$$E[ei] = 0 \text{ and } VAR[eit] = \sigma^2 ei \qquad (1)$$

nd where *Rit* is the return on security *i*at time *t*. The subscript *t* indicates the time, the subscript *i*indicates a specific security, and the subscript *m* indicates the market. *Rmt* is the return on the market portfolio during period *t*. The model's linear condition arises from the assumed normality of returns. The $\mathcal{E}_t$ is a random error term for security *i* at the time of *t*, and the βs are firm specific coefficients to be estimated.

Equation (1) is estimates a 255 - day estimation period from t = -11 to t = -265 where t = 0 is the event day. In this study, the window is defined as the period between 10 days prior to the event to 10 days after the event. The abnormal return (AR) due to the announcement on any given day of the event window is therefore equal to the actual return minus the predicted normal return, given by the prediction error:

$$AR_{it} = R_{it} - \alpha_i + \beta_i R_{mt} \quad (2)$$

According to previous researchers suggest that that abnormal performance measures such as standardized cumulative abnormal returns (SCARs) are less likely to generate false rejections of market efficiency. In addition, distributional properties and test statistics for cumulative abnormal returns are better understood.

Part IV- Analysis and Results

The results indicate that all international expansion events, on average, show negative abnormal returns during pre- and post- event day and on the actual event day. *SCARs – IMs' (M&As)*. A total of 763 events considered. Since significant for market reaction values are at (-10, +10), (-10, +5), (-5, +5) and (-5, +1), market does seem to react to M&A announcements in longer intervals and around the announcement day. At all intervals the market reacts positively to well over 50 percent of expansion announcements of acquirers from India where the z values for median and positives/negatives are both at 5 percent level. There seems to be value creation for Indian firms that expand internationally through M&As. (See Table 1, Appendix)

Part V-Conclusion

This study investigates the cross-border expansion implications on value creation of IMs for the period between 2000 and 2012. First, the paper explores the effects of cross-border expansion patterns on firm value creation. Second, it examines market reaction to the announcements of cross-border expansion patterns. Third, it evaluates firm performance in relation to the cross-border expansion activities.

This study finds that most IMs earn significantly positive abnormal returns during the event windows defined in this study.Hence, it is generally evident that there is value creation in cross-border expansion activities. According to the event-study results, value creation is mostly associated with

This positive effect is especially apparent a few days prior to the announcement in *informationally-efficient* markets. Therefore, this study shares the view of previous work, as M&As can be considered as value creation mechanisms. Furthermore, this study is also consistent with previous research on the value creation effects of M&As, as the previous expresses that establishing M&As creates significant value for the shareholders of all the partnering firms. The positive effects on value creation are more noticeable within technological alliances where firms experience greater abnormal returns.

Although value creation may beless apparent in the short- term for most expansions as in the case of M&As, it is certainly ostensible in the long-run. Hence, the study is consistent with previous research as the findings suggest the focus of IMs is now mostly related to efficient use of capital and resource.

Appendix

Event Study Table

Table 1: Daily and Standardized Cumulative Abnormal Returns of Cross-Border Expansion MA Announcements (Indian Firms)

The table presents the Daily and Standardized Cumulative Abnormal Returns (SCARs) of 763 cross-border MA expansion announcements by Indian Multinationals (IMs) originate from India over the 2000-2012period. Daily Standardized Cumulative Abnormal Returns (SCARs) are computed from the market model as prediction errors. Day 0 refers to the announcement day of acquisitions as reported SDC Database. Z-statistics [Wilcoxon Sign-Rank Test] is used to test for the statistical significance of mean [SCARs]. The statistical significance of mean [median] difference between groups is computed by One-Way ANOVA [Mann –Whitney Test for unmatched pairs]. Z statistics (Doukas' test) is used to test for the statistical significance of positives/negatives. ***, **, and * denote statistical significance at the 1%, 5%, 10% levels, respectively.

Indian Non-financial firms (2000-2012)

Day	Mean	Z-Value Mean	Median	WSRT-Z for Median	Positive:Negative	Doukas Z for Positive: Negative	Total Number of Events	Positive Market Reaction %
(-10,+10)	0.01760 **	2.15191	0.00830	1.01501	394:369	0.90506	763	51.64%
(-10,+5)	0.00932 **	1.93650	0.00520	1.08018	392:371	0.76025	763	51.38%
(-10,+2)	0.01618 ***	3.70978	0.00770 **	1.76584	407:356 **	1.84632	763	53.34%
(-10,+1)	0.01591 ***	3.78933	0.00880 **	2.09599	415:348 ***	2.42556	763	54.39%
(-10,0)	0.01313 ***	3.27085	0.00830 **	2.06755	419:344 ***	2.71518	763	54.91%
(-9,+9)	0.01977 ***	2.51299	0.00770	0.97893	415:348 ***	2.42556	763	54.39%
(-9,+5)	0.00986 **	2.14992	0.00540	1.17747	395:368	0.97747	763	51.77%
(-9,+2)	0.01671 ***	4.06029	0.00740 **	1.79784	413:350 **	2.28075	763	54.13%
(-9,+1)	0.01645 ***	4.15768	0.00760 **	1.92143	420:343 ***	2.78759	763	55.05%
(-9,0)	0.01367 ***	3.62695	0.00800 **	2.12286	414:349 ***	2.35316	763	54.26%
(-8,+8)	0.02041 ***	2.66734	0.00400	0.52263	400:363 *	1.33949	763	52.42%
(-8,+5)	0.01060 ***	2.39230	0.00500	1.12844	402:361 *	1.48430	763	52.69%
(-8,+2)	0.01746 ***	4.44802	0.00960 ***	2.44603	409:354 **	1.99113	763	53.60%
(-8,+1)	0.01719 ***	4.54550	0.01000 ***	2.64442	436:327 ***	3.94606	763	57.14%
(-8,0)	0.01441 ***	4.02821	0.00580 *	1.62131	409:354 **	1.99113	763	53.60%
(-5,+5)	0.01357 ***	3.51337	0.00580 *	1.50182	414:349 ***	2.35316	763	54.26%
(-5,+2)	0.02042 ***	6.19191	0.00870 ***	2.63753	431:332 ***	3.58404	763	56.49%
(-5,+1)	0.02016 ***	6.41346	0.01130 ***	3.59519	450:313 ***	4.95973	763	58.98%
(-5,0)	0.01738 ***	5.92791	0.01170 ***	3.99097	447:316 ***	4.74252	763	58.58%
(-4,+4)	0.01606 ***	4.52379	0.00740 **	2.08435	427:336 ***	3.29442	763	55.96%
(-4,+2)	0.01963 ***	6.29230	0.01120 ***	3.58963	434:329 ***	3.80126	763	56.88%
(-4,+1)	0.01937 ***	6.56420	0.01210 ***	4.10095	446:317 ***	4.67011	763	58.45%
(-4,0)	0.01659 ***	6.11505	0.01140 ***	4.20271	448:315 ***	4.81492	763	58.72%

(-3,+3)	0.01836 ***	5.96979	0.01210 ***	3.93419	437:326 ***	4.01847	763	57.27%
(-3,+2)	0.02008 ***	6.96605	0.01440 ***	4.99578	448:315 ***	4.81492	763	58.72%
(-3,+1)	0.01981 ***	7.38514	0.01390 ***	5.18122	472:291 ***	6.55264	763	61.86%
(-3,0)	0.01703 ***	7.15596	0.01180 ***	4.95691	459:304 ***	5.61138	763	60.16%
(-2,+2)	0.02055 ***	7.73050	0.01040 ***	3.91206	444:319 ***	4.52530	763	58.19%
(-2,+1)	0.02028 ***	8.26355	0.01310 ***	5.33725	468:295 ***	6.26302	763	61.34%
(-2,0)	0.01753 ***	8.13280	0.01020 ***	4.73270	460:302 ***	5.72374	762	60.37%
(-1,+1)	0.01859 ***	8.26046	0.00960 ***	4.26497	474:289 ***	6.69745	763	62.12%
(-1,0)	0.01584 ***	8.31999	0.00845 ***	4.43955	469:293 ***	6.37581	762	61.55%
(0,0)	0.01186 ***	8.72770	0.00555 ***	4.08457	456:304 ***	5.51362	760	60.00%
(0,+1)	0.01459 ***	7.92751	0.00670 ***	3.64035	454:309 ***	5.24935	763	59.50%
(0,+2)	0.01486 ***	7.03494	0.00700 ***	3.31442	436:327 ***	3.94606	763	57.14%
(0,+5)	0.00800 ***	2.69488	0.00430 *	1.44769	403:360 *	1.55670	763	52.82%
(0,+10)	0.01628 **	2.11290	0.00210	0.27257	392:371	0.76025	763	51.38%
(+1,+2)	0.00305 **	1.89999	-0.00150	-0.93553	365:398	-1.19468	763	47.84%

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