

The Global Indian Firm: Growth & Value Creation through Overseas Acquisitions

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This paper traces the recent explosive growth in overseas acquisitions by Indian firms and examines the primary reasons driving this trend. In their quest to become more globally competitive and have a global presence, Indian companies are engaging in overseas acquisition to primarily gain access to customers in new geographical markets, to gain new or advanced technologies or products, and to acquire management talent that has the mind-set and skills to operate businesses in more advanced or competitive conditions. Data show that thus far, Indian companies have also fared reasonably well in their acquisitions, both in terms of meeting their acquisition objectives and creating value for shareholders.

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Introduction

In recent years emerging multinationals have begun attracting attention in the business press (Economist 2008), as well as academic literature (Aulakh 2007, Khanna & Palepu 2006). They generally refer to a class of firms from emerging economies that are seeking to establish global presence and competitiveness in their respective business. From almost a negligible presence among global companies at the turn of this century, over 70 companies from emerging economies are in the FT Global 500 list by 2008, of which 62 are from Brazil, Russia, India and China (the BRIC economies). Indian firms form an important part of this category – as per a recent BCG study, 20 Indian firms are among the top 100 global challengers from developing countries. They include companies in the Tata or Aditya Birla Group, Reliance Industries, Infosys, Mahindra and Mahindra, Bharat Forge, Vedanta, and others (BCG 2009).

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The multi-nationality of these firms has broadly evolved through three phases (Aulakh 2007): a first phase wherein they expanded mainly into other developing economies (Lall 1983), a second phase wherein they became either more globally competitive in their home markets, or an integral part of the supply network of established multinationals, and a third phase wherein they are emerging as strong competitors in developed markets with capabilities to provide products/services to globally demanding customers. Indian companies have used a variety of strategies to build their international presence and position, and acquisition of overseas companies has been one of the widely used approaches in this endeavor. This new trend has received significant attention in the popular business press, wherein acquisitive Indian companies have even been referred to as 'marauding maharajahs' (Economist 2007). The growing interest and euphoria surrounding overseas acquisitions by Indian companies notwithstanding, several issues remain less understood in this context: what are the primary motivations for undertaking these acquisitions? How have Indian companies fared with their overseas acquisitions thus far? How are they managing their overseas acquisitions, and what challenges and opportunities lies ahead in their quest to establish global competitiveness and growth through acquisitions? In this article, we attempt to take a small step in examining some of these issues.

Indian firms' Overseas Acquisitions

During the last decade overseas acquisitions by Indian firms have exploded, both in terms of the number of deals they have done, and the value of those transactions. From just 11 deals valued at less than \$500 million in 1998, the number of overseas acquisitions crossed 230 with an aggregate value of over \$30 billion by end 2007 (Accenture 2008). The transactions include acquisitions by companies from large multi-business groups such as Tata (e.g. Tata Motor's acquisition of Daewoo Trucks and Jaguar-Land Rover, Tata Steel's acquisition of NatSteel and Corus, Tata Chemical's acquisition of Brunner Mond and General Chemicals, Tata Tea's acquisition of Tetley), Aditya Birla (e.g. Hindalco's acquisition of Novelis), or Mahindra and Mahindra (e.g. Mahindra Systech's acquisition of Stokes Plc., Jeco Holdings, etc.), large single business corporations like Bharat Forge, Suzlon, Wipro, or Dr Reddy's, or by medium sized companies such as United Phosphorous, Rolta and others. Our study of 412 overseas acquisitions by publicly traded Indian firms during 1998-2008 shows that these acquisitions occurred in a variety of industries; among them, the primary industries were computer software (26%), chemicals and pharmaceuticals (15%), auto and auto ancillaries (11%), consumer goods (8%), engineering (6%), metals (6%). In terms of geographical break-up, majority of the acquired companies were in developed countries (74%). Among developed countries, US-based companies account for the largest group (over 40%),

followed by those in Europe (UK, Germany, France, Belgium). These trends are quite similar to those observed in other recent studies on this subject (Gubbi et al forthcoming).

Why Overseas Acquisitions?

The traditional foreign direct investment (FDI) literature has adopted an asset exploitation perspective to explain a firm's internationalization. Accordingly, a firm internationalizes its business to exploit some proprietary advantage (such as superior technology, product know-how, etc) that it already possesses in the home market, to secure and enhance a competitive position in a new market (Hymer 1976, Makino et al 2002). However, some scholars have recently argued that a firm's internationalization is not only explained by the motivation to exploit its current assets in new markets, but also by the need to seek or acquire strategic assets that it lacks internally from other markets (Shan & Song 1997). Both perspectives can help understand Indian firms' motives to acquire overseas companies.

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After liberalization of India's business environment in 1991, many Indian firms transformed themselves into more customer-centric, improved

efficiency and productivity, and enhanced the quality of their products in the domestic market. Having made this progress, they began exploring opportunities to leverage their domestic products or position to expand into new geographic markets. Leveraging India's generally recognized low-cost location advantage was one of the underlying drivers in this process. But doing so would also diversify some of the operational risks in their business. Anand Mahindra, the Vice-Chairman of Mahindra and Mahindra, felt that by 2002 the company had developed a unique competitive advantage through its processes and position in the domestic farm equipment and utility vehicles business: the ability to produce quality goods at the lowest price per unit of innovation. He explains, "You have the confidence to be multinational only if your product development engine is something that delivers confidence to you, and you have the capability to create a sustainable pipeline of products and services that can pass muster around the world" (Kumar et al 2009). But companies like Mahindra still lacked some other aspects required to fully exploit their advantage in new markets, and acquisitions provide a relatively quick means to get them. For instance, they help companies get access to customers, distribution systems, local market know-how and brand recognition in the new markets they enter. For example, by the late 1990s Tata Tea had become a dominant player in India's branded tea market – but then when it sought to establish a global presence, it

realized the obstacles in doing so. “Developing brands overseas was not only time-consuming and costly, but also required knowledge of local conditions”, said Mr. K Krishna Kumar, the Vice-Chairman of Tata Tea. So it decided to acquire Tetley to accelerate its global expansion. Mr. Krishna Kumar explains, “We needed a vehicle, a brand to break into overseas market. Tetley presented that right opportunity. It was the second largest brand in the world.”

Leveraging India’s generally recognized low-cost location advantage was one of the underlying drivers in this process.

Liberalization also meant that foreign companies entered India in large numbers. So as competition in India became greater than before, customers had more choices and became more quality conscious, Indian companies had to up their game. But some Indian companies lacked the necessary technological or management expertise, and the scale or size to fight their foreign rivals – in which case, acquisitions of overseas companies provided part of the answer. By acquiring foreign firms, Indian companies were able to quickly get (and learn) some of the technology or capabilities they lacked. Mr. Ravi Kant, the Managing Director of Tata Motors said this in 2003 when his company acquired Daewoo Commercial Vehicles in Korea, “Tata Motors has been working on a world truck for India (and international markets). We now have a base to build it, rather than starting from

ground zero. The risks are reduced as we now have access to their technology and experience.” Later, as Indian companies gained the confidence to successfully take on foreign rivals in their local market and aspired to become more competitive in international markets, acquisitions of overseas companies played a vital role in infusing the required technology to improve the quality of their products/services for global markets. Apart from that, combining operations of the acquired company with their local operations also gave them greater scale and size to become cost-competitive at a global level. Hindalco’s acquisition of Novelis in North America is a case in point. As Kumar Birla, the chairman of Hindalco said, “This deal secures Hindalco’s position as a leading aluminum company in the world. Novelis brings critical technological expertise. With Novelis, we also gain immediate scale and a global footprint.” Finally, acquisition of overseas companies also provides Indian companies the management talent and expertise required to become global leaders. By acquiring a well run company in a developed economy they acquire management talent that is experienced in competing in advanced and competitive markets. Those executives are also well versed with, and well connected with, customers and institutions in those markets to help Indian acquirers overcome the liability of ‘foreignness’ and ‘Indianess’ when they expand their global footprint. Moreover, infusion of foreign practices and culture into the Indian acquirer can have a huge upside for the acquirer. As

one Indian CEO remarked, “To become a multinational, we need to embrace a culture of performance and innovation. Employees in the US-based company we have acquired bring that spirit and culture to our organization.”

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We surveyed the Indian companies that had undertaken one or more overseas acquisitions during 2003-2007 to understand their acquisition motivations. Exhibit 1 provides an overview of the replies from 89 respondents. Some of the most widely cited reasons for undertaking overseas acquisition are:

‘seeking access to new customers and markets’, and ‘acquiring technology, management talent, or brands’ from the acquired company. Some companies also see these acquisitions as a way to ‘realize cost advantages through economies of scale and size’, or ‘leverage India’s low cost advantage by shifting some operations from the acquired firm to India’. But the number of companies that seem to do acquisitions for the latter set of reasons is smaller than those who do it for the former. We also noted that a much greater proportion of Indian companies acquires firms in developed countries (74%) as compared to those in developing countries. This is perhaps not surprising since by acquiring firms in developed economies, Indian firms will realize their stated objectives in the quest to globally competitive.

**Exhibit 1: Primary Motivation for Undertaking Overseas Acquisitions
(Proportion of respondents who chose an item to be among its top 3 reasons)**

Reasons for undertaking an overseas acquisition	Percentage of Respondents
To achieve growth by getting access to new customers and markets quickly	87%
To gain or learn new or advanced technology from the acquired company	78%
To gain access to globally recognized or accepted products or brands	64%
To gain superior management practices and talent from the acquired company	72%
To create value through greater efficiencies by combining the scale or size of the acquirer and acquired companies	55%
To create value through cost reduction in the acquired company by relocating some of its activities to the acquirer’s lower cost India operations	48%
To create value through cost reduction by eliminating redundant activities across the two companies	35%
To secure supply of critical raw materials	26%

Overseas Acquisitions Successful or Value Creating?

Many studies have investigated how acquisitions perform, and whether they create value for companies involved in the transaction (King et al 2004). Most of these studies, barring a few, have examined this issue for acquisitions in or by developed country companies. This is not surprising because until recently acquisitions were a relatively rare phenomenon in emerging economy contexts. Studies on acquisition performance generally show that a large proportion of acquisitions fail, e.g., many studies show that acquisitions create zero or negative value for shareholders of the acquirer company (in terms of abnormal stock returns), whereas they create between +10-25% value for shareholders of the acquired company (Shimuzu et al 2004); in other words, they are good for shareholders of the acquired company, but not for that of the acquirer company. Others find that most acquirers fail to meet their stated objectives in a given transaction (Saxton & Dollinger 2004), or that there is no significant improvement in the return on investment of the acquirer (Datta & Grant 1990). Studies by consultants also reflect similar trends: McKinsey finds that 61% of acquisitions done by Fortune 200 firms have failed, whereas KPMG has observed that 83% of the deals done by US firms (of \$500 million value or more) have failed to create value for acquirers' shareholders (Bieshaar et al 2001). The performance of cross-border acquisitions is somewhat mixed. Some scholars find that cross-border

acquisitions are more likely to fail (Haspeslagh & Jemison 1991), whereas others find that they are more likely to succeed (Markides & Ittner 1994). Acquisition failure has been usually linked to one of the following factors: (a) lack of sufficient synergies between the combining firms, (b) overpayment for the target by the acquirer due to overestimation of expected synergies, existence of bidding or auction situations, or managerial hubris, and (d) failure of the acquirer to effectively manage the target during the post-acquisition period.

Many studies show that acquisitions create zero or negative value for shareholders of the acquirer company (in terms of abnormal stock returns).

How have Indian companies fared with their acquisitions? A few studies have investigated performance of domestic acquisitions by Indian firms, and they provide mixed evidence. Some find that Indian acquirers have created positive shareholder value (Kale 2004) when they acquire another Indian firm, whereas others see no such improvement in performance (Kumar 2009). As far as performance of overseas acquisitions by Indian firms is concerned, there is scant evidence in this regard. Therefore, we have undertaken an empirical study to evaluate this issue and we briefly report the results here. First, we assessed whether an overseas acquisition by an Indian company created value for its shareholders, in terms of abnormal stock

market gains following announcement of that acquisition. The choice of this measure is relevant on several counts. Prior research has used it extensively to evaluate performance of inorganic modes such as alliances (Anand & Khanna 2000), or acquisitions (Moeller & Schlingemann 2005). This ex-ante measure of performance has also been found to correlate well with ex-post measures of performance to demonstrate some predictive validity (Kale et al 2002). Finally, stock market based measures of performance are relatively unbiased compared to other measures and invariant to differences in accounting policies adopted by firms (Cording et al 2008). Second, we also assessed acquisition performance subjectively by using assessments by senior executives in firms directly involved with a given acquisition.

We were able to get data for 412 overseas acquisitions done by publicly-listed Indian firms during 1999-2008 to assess acquisition value creation, in terms of cumulative abnormal stock returns (Appendix 1 briefly outlines the approach we used in our study). We observed that overseas acquisitions, on

average, created a value of +1.76% (in terms of abnormal stock returns) for shareholders of the Indian acquirer firm. This is contrary to the negative value creation for acquirers usually observed in most prior literature. The average value creation in the first 5 years of this period (1999-2003) was +2.89%, whereas in the latter 5 years (2004-2008) it was down to +1.51%. Acquisitions of companies in developed economies, which account for almost three-fourths of the total number, created more value (+2.26%) for Indian companies than of companies in developing economies. The value creation in the latter case was statistically not different from zero. Our results are quite consistent with another recent study that has investigated this issue (Gubbi et al forthcoming). For a set of 89 transactions in this sample, we also collected survey data on managerial assessments of acquisition performance (Exhibit 2). It seems that executives of Indian companies are quite satisfied with the performance and outcome of their overseas acquisitions – they seem relatively less satisfied however, with the time period within which they have realized the benefits expected from a given acquisition.

Exhibit 2: Evaluation of Acquisition Performance based on Managerial Assessments*

	Avg. Rating
We have achieved most of our expected objectives in doing this acquisition	5.87
The acquisition has provided the desired benefits to both companies	5.45
We are satisfied with the overall performance of this acquisition	5.23
We have realized the desired benefits in this acquisition in the expected time-frame	4.29

**Respondents evaluated their acquisition on each of the above items using a 7-point rating scale, where '1=Strongly Disagree' and '7=Strongly Agree'*

Overall, some of our results are somewhat different from the low levels of acquisition success or value creation observed by prior researchers hence future studies need to investigate the underlying reasons that might explain it. One, the success of Indian acquirers might be partly linked to the fact they have generally acquired smaller sized companies that are easier to manage. Although the popular business press provides greater coverage and emphasis on large sized deals that run into hundreds of millions of dollars, the average ticket size of the overseas acquisitions done by the most Indian companies is quite small. For example, for the companies in our sample the average deal size (during 1999-2008) was just over \$48 million. But if they acquire larger companies over time, will this change? Two, it is plausible that the experience of Indian acquirers is also linked to the nature of companies they have acquired, or how they were managed by the Indian acquirer. We briefly examine this latter aspect in the next section.

Managing Overseas Acquisitions by Indian Acquirers

Our analysis of various press reports, in-depth fieldwork and interviews with several Indian CEOs and senior executives and our ongoing data collection through surveys seems to suggest that Indian companies' approach to managing acquisitions differs somewhat from what has been usually observed in acquisitions undertaken by developed country multinationals.

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During the post-acquisition integration period, acquirers have to decide 'how much' or 'to what extent' they should integrate the acquired company with their own organization, in terms of its structure and operations. At one extreme, they can fully integrate or 'absorb' the acquired company such that it ceases to have any identity as a separate organization, whereas at the other extreme they can fully 'preserve' the acquired company in its original form, barring the change in ownership that has taken place (Haspeslagh & Jemison 1991). Usually, many western companies prefer to integrate the operations of the acquired company as fully as possible with themselves to facilitate elimination of duplicate activities, and realize cost synergies through scale or scope economies by combining their operations. The acquirer also attempts to integrate the acquired company as quickly as possible to realize the expected benefits at the earliest. Most Indian acquirer, however, seems to take a different approach in this respect. They seem to adopt little or no integration between the acquired company and themselves, and even if they do it a bit, they do it more gradually over time. Lower level of integration has some obvious benefits: While providing some of the above mentioned benefits,

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greater integration can potentially disrupt the operating routines and resources in both the companies, and also create greater complexity in combining their respective operations. Both of these can adversely impact the performance of both the organizations, and acquirers can avoid this by lowering the degree of integration between the combining firms, which is what Indian companies seem to prefer. However, to realize some of the expected benefits of coming together, Indian companies just coordinate some selective activities between the two firms, while leaving them independent otherwise. For instance, the purchasing groups of the two firms work with each other to consolidate their purchases to achieve better volume discounts and reduce joint logistics costs, as was the case in Tata Steel and Corus. Also, while leaving the two firms separate, some Indian firms attempt to align their budgeting and planning cycles too so that their strategies and plans are in sync with one another. In some cases, they adopt the same or similar financial reporting and IT systems and practices to facilitate the sharing and use of common information and metrics. Mahindra's auto component business has taken this approach in managing its numerous acquisitions in Europe. The pace of any integration or

coordination that Indian companies pursue is also slower – as the CEO of an Indian IT company that has done several acquisitions says, “Taking it a bit slowly gives us more time to understand our overseas partners’ operating style and culture, enable generation of mutual comfort and trust between us, and help us better identify points of selective intervention instead of hastily rushing into them.”

Many western firms also prefer to replace the senior management team of the acquired firm with their own executives, whenever they undertake any acquisition (Zollo & Singh 2004). This practice is quite consistent with the ‘market for corporate control’ perspective prevalent in the US wherein one firm acquires another firm to supposedly create value by replacing its ‘ineffective management’ by its own managers who will hopefully run the acquired company more efficiently and effectively. Indian acquirers of overseas firms take an opposite approach. In most cases, we see that senior executives of the acquired firm are retained by the Indian acquirer. They are also given a lot of freedom and autonomy in running their operations, which as we mentioned earlier, are quite separate and independent even after the acquisition. Mr. Ravi Kant, the CEO of Tata Motors who oversaw its acquisition of Daewoo Commercial Vehicles of Korea had this

Senior executives of the acquired firm are retained by the Indian acquirer.

to say, “The operation would be run basically by Koreans. That would give them a sense of pride.” Apart from this benefit, there are other advantages in retaining the management team and employees of the acquired company. They have a good understanding of their local market and customers, the nature of the regulatory environment in their countries and they possess the relevant social networks to navigate through them – all of which are critical to the Indian acquirer. In addition, these executives can transfer some of their global and international experience and expertise back to the Indian acquirer to transform its own processes and practices, as was the case when VSNL acquired Teleglobe of Canada which was a leading provider to wholesale telecom services and solutions to over 150 international telecom companies. Indian acquirers don’t seem restrict their retention of resources in the acquired firm to just its managerial assets, but extend it to other resources as well such as their brands and distribution channels. For instance, when VIP Industries acquired Carlton, a long-standing soft luggage company in the U.K., they strived to preserve Carlton’s brand identity in every way by keeping it separate from VIP. The idea was to keep Carlton’s U.K heritage intact to facilitate VIP’s entry into the sophisticated and lucrative high-end European market.

Although Indian firms’ approach to post-acquisition management is different from what many Western acquirers would do in their acquisitions, it seems understandable given some of their

Indian acquirers don’t seem restrict their retention of resources in the acquired firm to just its managerial assets, but extend it to other resources as well such as their brands and distribution channels.

primary motivations for doing overseas acquisitions. As we reported earlier, their rationale for overseas acquisitions is not just to create value by cost reduction through rationalization, elimination of redundancies and exploitation of scale and scope economies. It is also about using these companies (and their brands, technology, management know-how) to expand their international footprint, accelerate sales growth, improve product and process quality and in some cases even transform their own culture and mind-set to make it more suited to compete in the global environment. In light of these objectives, their actions related to the level or speed of integration, the extent to which they replace resources in the acquired company, or the autonomy they grant to these companies seems appropriate. That said, there are some concerns or risks with this approach, and Indian acquirers need to understand that. Reducing the level of integration between the combining firms, or going about it slowly can adversely affect not only the magnitude of the expected synergy benefits between the two companies but also the speed with which they are realized – and both of these aspects are critical given that an Indian acquirer has already paid an upfront price (usually in cash) for taking over the acquired

company. Similarly, the practice of retaining the management team and employees in the acquired company can possibly create a stereo-typical image of Indian acquirers going forward – that they are benign acquirers who are hesitant to ruffle feathers in the companies they acquire. Thus going forward, Indian managers need to guard against these risks, and academic scholars need to investigate their nature, extent and impact in greater detail.

Conclusion

This paper traces the recent growth in overseas acquisitions by Indian firms and examines the primary reasons driving this trend. In their quest to become globally competitive and have a global presence, Indian companies are engaging in overseas acquisitions to primarily gain access to customers in new geographical markets more quickly, to gain advanced technologies or products, and to acquire management talent with the mind-set and skills to operate businesses in more advanced or competitive conditions. Data show that thus far, Indian companies have fared reasonably well in their acquisitions, both in terms of meeting their acquisition objectives and creating value for shareholders. As outlined in the paper, it is possible that part of their success is linked to the deliberate, collaborative approach they have adopted to manage these transactions– but there are some risks in this approach too, and future research needs to examine them in greater detail.

Data show that thus far, Indian companies have fared reasonably well in their acquisitions, both in terms of meeting their acquisition objectives and creating value for shareholders.

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Appendix- I

We used the event methodology to assess acquisition value creation in terms of cumulative abnormal returns. Using

the procedure outlined by Brown and Warner (1985) and others, we first calculated the daily abnormal stock

returns (AR_{it}) to the shareholders of an acquirer Indian firm 'i' for day 't' by controlling for both the market return and the firm-specific return such that:

$$AR_{it} = R_{it} - (a_i + b_i R_{mt})$$

R_{it} is the acquirer firm i's actual return on day 't' and R_{mt} is the return on a market index for that same day. The term within parentheses is the acquirer firm's expected share price normal return on that day, and it is estimated by regressing the firm's daily share price return on the daily market return over a 180-day period preceding the acquisition event. The corresponding constant and the coefficient from the above regression are a_i and b_i respectively. For the purpose

of our analysis, we used the BSE Sensex to estimate the daily market return.

Using the above approach, we estimated daily abnormal returns for each acquirer firm over a fourteen-day period (-10 to +3) surrounding its acquisitions. In line with normal practice, we then aggregated these returns to estimate a firm's cumulative abnormal return over a 14-day period surrounding its acquisition. We also replicated the analysis by using a smaller event window (-3 to +3 days, or -3 to +1 day), and by using the Nifty Index instead of the BSE Sensex. Although the magnitude of the cumulative returns was a bit lower in both cases, the results did not change substantially in terms of their overall trend or significance.