RELEVANCE OF INDIAN MERGERS & ACQUISITONS TO FDI

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ABSTRACT

The paper aims at analyzing the trend of mergers and acquisitions in India and the impact of foreign direct investment (FDI) on Mergers and acquisitions (M&As). The trend of Mergers and acquisitions is on raise at every nuke and corner of the world. The transformation of international trade to international business is the key aspect that stressed on mergers and acquisitions in many developing countries around world. This transformation extended further with the introduction of Foreign Direct Investment (FDIs) policies by many nations. Many modern M&A deals are based on and affected by the FDI norms of countries. In the present paper, we are focusing on the latest amendments to FDI norms of India and their implications on cross border M&A deals.

Keywords: *Mergers and acquisitions, foreign direct investments (FDI), FDIs growth in India, International trade*

INTRODUCTION

The quest of modern business for new sources of capital and also the demand for new, improved tangible and intangible assets made cross border deals among business houses a quiet common activity. There are numerous number of cross border transactions took place in 1980's yet the most instrumental and revolutionary deals were initiated during 1990's when the concept of foreign direct investments (FDI) had been introduced to the world economy. All the countries including developed nations welcomed this as, they found a new arena for their goods and services, while developing countries can fill up their thrust for capital and poor countries can manufacture products of their own. The FDI enters a country either through a green investment or through various other strategic modes such as, mergers, acquisitions, takeover and many more. All the modes of entry are quite popular but cross border Mergers and acquisitions are the most preferred transactions as they create an immediate market presence for the foreign company in an alien market. The domestic resources that are underutilized due to lack of capital and proper control would be utilized in a right way through cross border M&As. Here is where the foreign investment or FDI make its presence and utilizes such underutilized resources effectively and efficiently. Before initiating M&A analysis and their association with FDI norms of a country let us have a view on the description of mergers, acquisitions, FDIs and their interrelations. The description would throw a light on the concepts of discussion in this paper.

- **Merger** - Merger which is known as amalgamation(as per Indian Companies act,1947, Income tax act,1973), is nothing but combination of two or more companies through which one company gets the overall control on the other company or companies. In short, the company which is merging with another (merged) company would lose its identity and is no longer in existence. Generally merger takes place between two equals. According to Income Tax Act, 1961 "The merger of one or more companies with another company or the merger of two or more companies to form one company"[1]. In India the conceptual and legal proceedings of merger are being done through various laws and regulatory guidelines that would ensure the deal to be fair and mutually benefited. The most recent remarkable merger that took place between HDFC and Max life insurance and had made HDFC life, the largest listed life insurance company in India. According to various analyses 2015 has been noted as biggest year ever for M&A deals in India. The slew of smaller takeovers that took place in the

[1] Nishith Desai associates Legal and Tax counseling world wide – Mergers & Acquisitions in Inida

last Quarter of the financial year 2015-16 made India a destination for many smaller M&As. However, the slew also followed in current financial year as there are many M&A proposals on rolls by now.

- **Acquisition** - Unlike merger, acquisition refers to acquiring a part of an organization or buying out control on few divisions of another organization. In case of acquisitions both acquiring and acquired companies continue to be separate legal entities with few modifications in the control and management of the acquired organization. Financial Times defines an acquisition takes place, "when a company (typically referred to as the 'acquirer', 'buyer' or 'bidder') purchases a second, usually smaller, company(called the acquire or target); the second company either be continued as a separate legal entity or ceases to exist and the assets of the target are then integrated into the buying company."[2]. There were many renowned acquisitions that had taken place in the last financial year which had contributed to a remarkable growth in the overall net worth of the companies and were also added to the best ever M&A deals bag of the country.
- **Foreign direct investment (FDI)** – FDI refers to investment by an entity of some other country in the businesses of companies of another country. FDIs can be made either by buying out another company or by expanding operations in new markets. The role of one company in another company extends from long term participation in management and support in various production and technological aspects of business by country A's company in Country B's company. In short, FDI opens trade doors for a foreign country company in our domestic companies. FDI is the best explained as the modern vehicle for expanding one's business beyond national boundaries. IMF defines FDI as "The acquisition of at least ten percent of the ordinary shares or voting power in a public or private enterprise by nonresident investors. Direct investment involves a lasting interest in the management of an enterprise and includes reinvestment of profits"[3]. The regulatory frame work for FDIs in India is governed by various laws such as, Foreign exchange and regulation Act, 1974 and so on. All these regulatory guideline ensures free flow of investments to the country while protecting the interests of domestic players. As per the reports of Reserve bank of India, the FDIs to India are record high in the year 2008 and a record low in the year 2014. However, the recent add-ons or liberalizations by Government of India would definitely be value additions for FDIs. The details of FDI norms and their implications will be discussed further in the paper.

2. INTERRELATION BETWEEN M&As AND FDI

The trend of Mergers and acquisitions is not new in this fast changing and rapidly transforming 21st century. The strides of globalization had made cross border mergers and acquisitions a most common phenomenon in the present business world. Though this phenomenal transformations made the deals of M&As much easier and flexible but also added many macro factors to be considered by modern business tycoons before pairing up with the companies of another countries.

One such international aspect of importance for many developing countries that would expect to raise their growth is foreign direct investment, in short FDI. FDI is the channel through which any developed country with excess supply or exploration opportunity would enter any developing country across world. The trend of FDIs initiated during 19th century when the international trade regime had been transformed and succeeded by international business regime. The international business regime had stressed on the need for having a communal and cooperative business practices across globe for mutual and overall growth of the nations. Such thought adopted by many developed countries and cooperative associations like WTO, IMF etc... Strived for more capital inflows to many developing countries like India, China etc...

[2] http://lexicon.ft.com/Term?term=acquisition
[3] http://www.ccsenet.org/journal/index.php/ijbm/article/viewFile/10596/8777

Back in 1990's before 1991 LPG policy India followed restrictive foreign investment policies which were removed and replaced to a greater extent post 1991 reforms. The foreign investment in today's business world is being perceived as a source of scarce capital, technological and managerial skills that are instrumental for the success of any business house. Out of all rapidly growing south-east Asian nations, India is one of the benchmark destinations for many foreign investors. This has been proven by recent reports by Indian Finance ministry published in Financial Times, London. As per the report India topped the list of destinations for Greenfield investments (measured by estimated capital expenditure) in the first half of 2015. The report said India has attracted $31billion of FDI in HI, 2015 followed by china with $28billion and then by US with $27 billion.

The report shows that India crossed china by $3 billion and US by $4 billion. In the same report of last financial year i.e., during 2013-2014 India ranked 5th in terms of capital investment, after china, the US, the UK and Mexico. The report also mentioned that India has experienced one of 2014's best FDI growth rates, increasing its number of projects by 47% while many major FDI destinations across globe suffered a decline. The report and the recent amendments to the FDI policy of India are positive signs for country and also for many sick units which can utilize the opportunity to renovate and reinvent themselves.

3. ROLE OF FDI'S IN MERGERS AND ACQUISITIONS

FDIs being the only channel of cross border source of capital facilitate free flow of certain set of skills and sources from one country to another. There is handsome number of ways that a foreign company can enter a domestic market but the most preferred or popular mode of entrance is through M&A deals. Perhaps, M&As ensures mutual benefits to both the host and guest nations and operates on synergy. The recent FDI flows come with a value addition in the form of green field investment in which the parent company of a foreign nation would build its own operating and production facilities in the hosting country. The green field investment by foreign nation's benefit the hosting nations as the company will be treated as an equivalent to a domestic company. This move of treating the foreign company as a domestic company would improve the market capitalization of merged or newly formed entity in both domestic as well as foreign companies. The latest reports by Reserve bank of India on FDI inflows for a period of July 2015 – April2016 would throw a light on how the year 2016 attracted more foreign investments to India,

Figure I: Growth of FDI flow to India - Jul 2015 – April 2016

As per the above information by RBI the FDI flows had experienced a peak in October, 2015 which was lowered for about a quarter. Later again rose to $4413 million and eventually dropped in next few months. However, as the new FDI policy is on rise and the world's sentiments towards India as one of the benchmark destinations for investments would definitely make India the most favored nation for foreign investments. The reports on FDI by RBI have stated that, Foreign Direct Investment in India increased by

1547 USD Million in May of 2016. Foreign Direct Investment in India averaged 1153.89 USD Million from 1995 until 2016, reaching an all time high of 5670 USD Million in February of 2008 and a record low of -60 USD Million in February of 2014.

4. RECENT FDI POLICY FRAMEWORK BY GOVERNMENT OF INDIA

The key decisions and modifications to FDI policy of India by government of India in the month of June, 2016 has extended and opened doors for further more foreign investments. The move taken by the GOI as a part of its Make in India campaign will depict its results soon after the completion of financial year 2016. The proposed modified policy guidelines come into force from June, 2016 expecting a flood of investments to India. India is expecting to grow more with this rapid and eye striking changes to the policy norms while sustaining its 10th position in FDI confidence index by UNCTAD (United Nations Conference on Trade and Development).

The government has termed its new reform to FDI policy as a "radical liberalization of FDI regime" as the India is opens for FDIs of 100% in almost all the key sectors of the country. The decision by the GOI would now allow global giants like Apple to set up their own retail outlets in the country. Here we are presenting few key reforms under FDI policy, 2016

- ✓ The primary sector of the country i.e., Agriculture allows 100% equity or FDI capital through an automatic route in the areas such as , Floriculture, Horticulture, Apiculture and Cultivation of Vegetables & Mushrooms under controlled conditions, Development and Production of seeds and planting material; Animal Husbandry (including breeding of dogs), Pisciculture, Aquaculture, under controlled conditions; and Services related to agro and allied sectors.(Besides the above, FDI is not allowed in any other agricultural sector/activity).
- ✓ Mining and Exploration of metal and non-metal ores allows 100% equity or FDI capital through automatic route which includes diamond, gold, silver and precious ores but excluding titanium bearing minerals and its ores.
- ✓ Coal & Lignite mining for captive consumption by power projects, iron & steel and cement units and other eligible activities such as Setting up coal processing plants like washeries allow 100% equity or FDI capital through automatic route.
- ✓ Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities allow 100% equity or FDI capital through government.
- ✓ Exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas .Their marketing activities and research areas also are foreign funded upto100% of equity or FDI capital through automatic entry route.
- ✓ Petroleum refining by the Public Sector Undertakings (PSU), without any disinvestment or dilution of domestic equity in the existing PSUs up to 49% of equity or FDI capital through automatic entry route.
- ✓ Defense Industry allows 100% equity or FDI capital but only up to 49% through automatic route and above 49% under Government route on case to case basis
- ✓ Broad casting services such as, Teleports, Direct to Home (DTH), Cable Networks, Mobile TV Headed-in-the Sky Broadcasting Service (HITS) would allow 100% equity or FDI capital but only up to 49% through automatic route beyond 49% through government route.
- ✓ Broadcasting content services up to 49% through government route. Whereas, in the area of Up-linking of Non-'News & Current Affairs' TV Channels/ Down-linking of TV Channels the FDI capital is up to 100% through automatic entry route.
- ✓ Print media such as, Publishing of newspaper and periodicals dealing with news and current affairs FDI or equity capital up to 26% through government route.
- ✓ Publishing/printing of scientific and technical magazines/specialty journals/ periodicals and also publication of facsimile edition of foreign newspapers the percentage of FDI or equity capital is up to 100% through government route.

- ✓ In civil aviation industry for construction of airports through green field investment up to 100% of FDI capital through automatic route whereas through existing investments up to 74% through automatic route, beyond 74% through government route.
- ✓ In the area of air transport services , Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline 49% FDI capital (100% for NRIs) through automatic route of entry. For non-scheduled Air transport services and helicopter services FDI capital up to 100% through automatic route.
- ✓ In real estate's Construction and Development of Townships, Housing, Built-up Infrastructure FDI capital up to 100%through automatic route.
- ✓ For construction and development of Industrial parks up to 100% FDI capital through automatic route.
- ✓ Satellites- establishment and operation up to 100% FDI capital through government route.
- ✓ Private Security Agencies up to 49% FDI capital through government route.
- ✓ Telecom Services (including Telecom Infrastructure) up to 100% FDI capital out of which up to 49% through automatic route and beyond 49% through government route.
- ✓ Cash & Carry Wholesale Trading/Wholesale Trading up to 100% FDI capital through automatic route.
- ✓ E-commerce activities trading up to 100% FDI capital through automatic route.
- ✓ Single Brand product retail trading up to 100% FDI capital in which up to 49% through automatic route and beyond 49% through government route.
- ✓ Multi Brand Retail Trading up to 51% of equity or FDI cap through government route.
- ✓ Railway Infrastructure Construction, operation and maintenance 100% FDI cap through automatic route.
- ✓ FDI in ARCs (Asset Reconstruction Companies) is up to 100% through automatic route.
- ✓ Banking – private sector FDI cap up to 74% out of which, Automatic up to 49%, Government route beyond 49% and up to 74%.
- ✓ Banking- Public Sector FDI cap up to 20% through government route.
- ✓ Credit Information Companies FDI cap up to 100% through automatic route.
- ✓ Infrastructure companies in Securities Markets, namely, stock exchanges, commodity exchanges, depositories and clearing corporations, in compliance with SEBI Regulations up to 49% through automatic route.
- ✓ In insurance industry the FDI cap is up to 49% through government route.
- ✓ Pension sector FDI cap up to 49% through automatic route.
- ✓ Power Exchanges FDI cap up to 49% through automatic route
- ✓ White Label ATM Operations up to 100% through automatic route.
- ✓ In the area of NBFCs FDI cap up to 100% through automatic route.

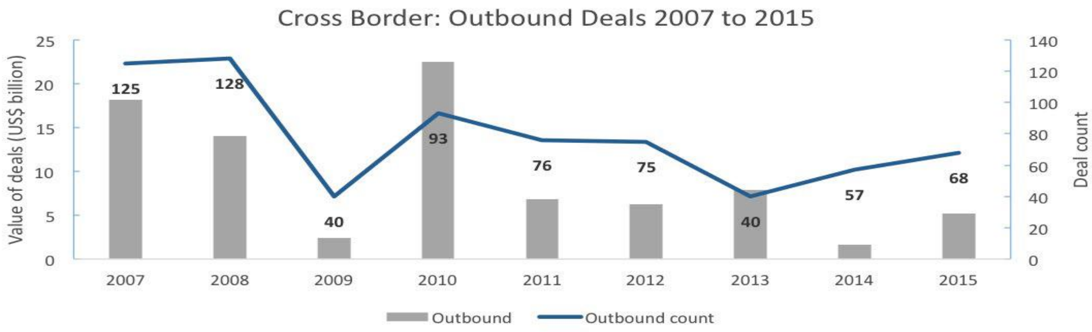
5. EFFECT OF RECET FDI NORMS ON M&A'S

In the year 2015, India's M&A activity witnessed the highest ever annual volume, accounting for 9.7% of total Asia-Pacific market a total of 409 deals were announced aggregating to US$ 35.9 billion. Deal value saw a minor decrease of 4.4% as compared with 2014, a result of fewer large cap deals. Average deal size decreased to US$ 87.8 Million as compared with US$ 119.9 million in 2014.Cross border deals drove momentum for the Indian M&A market.

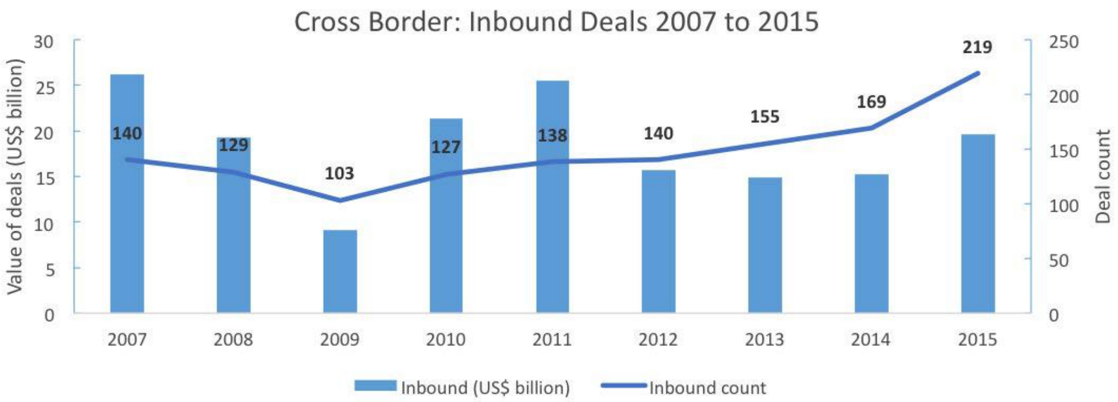
A total of 219 inbound deals (up by 30% from 2014) and 68 outbound deals (up by 20% from 2014) resulted in a total cross border deal size of US$ 24.8 billion, accounting for over 2/3rd of the India M&A market. Total inbound deal value stood at US$ 19.6 billion, witnessing the highest ever deal value since 2011 (US$ 25.5 billion). The overall M&A activity of India is at a progressive phase since 2007 till 2015. Though there are few lows during the decade the overall growth is impressive and trajectory almost in all the sectors.

Figure II: M&A activity in India (2012-2015) in US$ million

Out bound M&A deals growth since 2017- 2015: The capital flow from India to foreign nations is also impressive and momentous in FY2015 compared to FY2014



Inbound M&A deals growth since 2007-2015: The inflows to India through FDIs are also growing at a relatively good amount since 2012. The latest amendments to FDI policy by GOI would extend this trend further hopefully.



A report by Reserve bank of India also witnessed a steep increase in FDI flows to India which depicts there are handsome number of opportunities for India to grow further if India is able to monetize the foreign investments properly by improving or indulging in more number of M&A deals in the next quarters of the Financial year 2016.

Table I: RBI report on India's BOP: 2015-2016

India Trade	Last	Previous	Highest	Lowest	Unit
Balance of Trade	-7761.40	-8116.20	258.90	-20210.90	USD Million
Exports	21689.60	22572.30	30541.44	59.01	USD Million
Imports	29451.00	30688.50	45281.90	117.40	USD Million
Current Account	-300.00	-7100.00	7360.00	-31857.20	USD Million
Current Account to GDP	-1.25	-1.31	2.28	-4.82	Percent
External Debt	485614.00	479677.00	485614.00	96392.00	USD Million
Terms of Trade	57.90	60.20	100.00	57.90	Index Points
Capital Flows	200.00	17.92	766.96	-271.46	USD Million
Foreign Direct Investment	1547.00	2092.00	5670.00	-60.00	USD Million
Remittances	8472.83	8468.59	12293.40	5999.10	USD Million
Tourist Arrivals	550000.00	529000.00	913000.00	129286.00	
Gold Reserves	557.74	557.74	557.74	357.75Tons	
Crude Oil Production	758.00	757.00	813.00	526.00BBLD/1K	
Terrorism Index	7.75	7.70	8.09	7.22	
Weapons Sales	33.00	53.00	53.00	1.00USD Million	

6. CROSS BORDER M&A'S DEALS

Corporate India's merger and acquisitions deal tally for April-June 2016 stood at USD 7 billion, up 14 per cent from the corresponding quarter a year ago, largely driven by big ticket transactions, an EY report says. According to EY's recent Transactions Quarterly report, there were 190 deals with a total disclosed deal value of USD 7.0 billion in the second quarter of this year, while transactions worth USD 6.1 billion were announced in the corresponding period last year. Top10 outbound mergers ever by Indian companies have been listed below

Table II Top Cross border deals so far in India

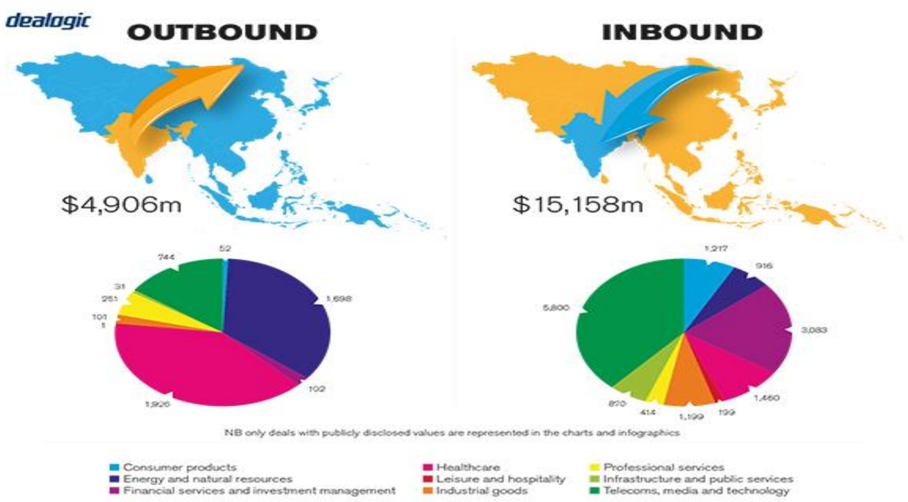
Acquirer Company	Targeted Company	Deal Value (In Billions)	Industry
Tata Steel	Corus (UK)	$12.2	Steel
Hindalco Industries	Novelis Inc (USA)	$6	Aluminum
Oil & Natural Gas Corp (ONGC) Videsh Ltd	Imperial Energy PLC (UK)	$2.8	Oil & Gas

Tata Motors Ltd	Jaguar & Land Rover Operations (UK)	$2.3	Automotive
Suzlon Energy Ltd	RE Power (Germany)	$1.7	Power & Energy
Essar Steel Holdings Limited	Algoma Steel Inc (Canada)	$1.58	Steel
United Spirits	Whyte & Mackay (UK)	$1.11	Breweries & Distilleries
Tata Power	PT Kaltim Prima Coal; PT Arutmin Indonesia (30% Stake - Indonesia)	$1.10	Power & Energy
GMR Infrastructure Ltd	InterGen NV (50% - Stake Netherlands)	$ 1,10	Power & Energy
Tata Chemicals Limited	General Chemical (USA)	$1	Plastic & Chemical

CONCLUSION

Though the flow of investments into economy effects domestic industries, the economies of scale are at large than the negative effects. The best exemplification for it has been depicted by the statistics given by various national and international sources of information. Especially countries like India that had sustained many global break-downs can be further highlighted by using the economies of scale of FDIs. The Gross domestic product (GDP) of many developed countries have also been grown considerably while many poor and developing countries have shown a considerable hike in their GDP during last decades. The projections by UNCTAD for India FY:2014-15(3.1%) have proved this and also the share of BRICS in global FDI flows which are totaled to $322billion and is 22% of the overall world's flows also have proven the growth of FDIs in promoting economic growth and development. The total number of inbound and outbound merger and acquisition deals in different industries that took place by now is the best exemplifications of FDI flow to and from India.

Figure III: Inbound and outbound FDI of India



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