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Achieving global economies of scale through inorganic growth

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Abstract:
The Indian business environment has changed drastically since 1991 with the changes in the economic policies and introduction of new institutional mechanisms. In the last few years, quantum jump in the number of people who wish to buy or sell companies has been observed. Thus M & A are not new to Indian Economy, now. Though M&A does not lead to market creation it does offer multiple benefits to organisations employing M&A as a growth strategy. These include, geographic market expansion, increasing product lines, availing economies of scale leading to price competitiveness and many more. Indian companies across the sector are looking forward to the opportunity presented by pandemic. The mergers and acquisitions are now more strategic in nature. As the companies look forward to reworking on their business portfolio for enhance profitability, more opportunities are being created for M&A.
This paper analyses various M&A in the country and their motives.
Key Words: M&A, Synergy, Economies of scale.

Achieving global economies of scale through inorganic growth

Acquisition is different from merger. Acquisition implies that a company unilaterally relinquishes its independence and adapts to another firm's plans, while in mergers all combining firms relinquish their independence and cooperate, resulting in a common corporation[i].

From the economic point of view, there are four types of mergers:

Horizontal merger involves the uniting of two or more firms in the same field.

Vertical merger refers to integration of companies having supplementary relationships either in production or distribution of products or services.

Circular merger involves the bringing together of products or services that are unrelated but marketed through the same channels, allowing shared dealerships.

Conglomerate merger refers to unification of different kinds of businesses under one Flagship Company.

Globally Mergers and Acquisitions (M&A) have been employed as a strategy for corporate growth. India has not been an exception to this inorganic growth strategy. However, post liberalization in India M&A have become more strategic than pre liberalization period. Though M&A does not create new market, it offers multiple advantages and synergies in the business. Many authors have highlighted the benefits and objectives of M&A.

Kitching John[ii], while analyzing why the mergers miscarry, had analyzed various motives for the M & As. He observed that any acquisition takes place with a number of motivations culminating in a positive synergy. This means that the performance of the combined company is more than the sum of the two independent companies.

He has stated the findings of a study conducted in the USA, which identified 12 motives that promote M & A activity. They are given below in the order of their priority.

1. Take advantage of awareness that a company is undervalued,
2. Achieve growth more rapidly than by internal efforts,
3. Satisfy market demand for additional product/service,
4. Avoid risks of internal start-ups of expansion,
5. Increase earnings per share,
6. Reduce dependence on a single product / service,

7. Acquire market share or position,
8. Off set seasonal or cyclical fluctuations in the present business,
9. Enhance the power and prestige of the owner, CEO or management,
10. Increase utilization of present resources – e.g. physical plant and individual skills,
11. Acquire outstanding management of technical person,
12. Open new markets for present products / services.

Organization for Economic Cooperation and Development (OECD)[iii] pushed a report of their committee of Experts on Restrictive Business Practices, on "Mergers and Competition Policy". The report listed twelve motives most often cited for mergers, which may be grouped together under the following categories.

A. Economies of Scale Related reason	Obtain real economies of scale,
	Acquire capacity at reduced prices
B. Market Share reason	Increase market power,
	Expand production without price reduction,
	Build an empire
	Rationalize production,
C. Financial synergy Related reasons	Obtain tax advantages,
	Obtain monetary economies of scale,
	Use complementary resources
	Gain promotional profits.
D. Diversification Risk related reasons	Spread risks by diversification
	Avoid firm's failure.

U.S. Federal Trade Commission[iv] conducted a survey in 1955 to find out why companies choose the merger and acquisition route, listed seven major benefits of acquisition for the acquiring company. They are:

1. Gaining additional capacity to supply to a market already being serviced by the acquirer,
2. Gaining extended product lines,
3. Achieve diversification of product base,
4. Gaining facilities to produce goods purchased earlier,
5. Gaining facilities to process or distribute goods sold earlier,
6. Gaining access to additional markets,
7. Other advantages such as empty plants, control of patents etc.

India incorporation has seen increased mergers and acquisitions in the recent past. There are numerous motives for the upsurge in leap of mergers. Several organizations during the last few years have deleveraged and have a potent balance sheet. Post Covid they are chasing inorganic growth, because of the problems in putting up greenfield projects. Micro and macro environments are contributing too. The corporate balance sheet is robust. Buoyancy is high. Organizations with greater risk inclination and drive to grow fast are exploring M & A opportunities. Currently it is the appropriate time for organizations to rearrange their portfolio of businesses. When the organizations are looking for global economies of scale, their perspective is universe and they are benchmarking their magnitude against organizations in the universal market. In order to achieve these objectives organizations are working on bringing down the costs, improving productivity, acquiring volumes to grow and achieve competitive prices.

Like in case of sectors, the phenomenon could be seen across industry, as corporates will also be streamlining their portfolios through M&A, by focusing on profit pools of the future in the areas such as digital, renewables, electric vehicles, and fintech. To fund these moves and manage their portfolios corporates are clipping possessions in inherited assets or in subscale positions that could be more valuable in another corporate. Multiple examples prove this point. Mindtree was acquired by L & T through a hostile bid in 2019. The merger would place the combined entity amongst the top six IT firms[v].

In some cases, mergers have been guided more by the need to survive through consolidation[vi]. For instance, PVR's merger with Inox Leisure. The nearclosure of theatres during the pandemic saw firms in the entertainment distribution sector grieving badly. As an alternative to challenging against each other Inox Leisure found it wise to join hands, reckoning that merger may give them improved bargaining power. However, the merged entity's all problems may not be overcome. The escalating OTT mobile apps, could in near future force the company to look at making content in a bid to diversify their revenue stream. In this entertainment segment, a big deal will also be seen in the Sony-Zee merger which is likely to come into efffect by March 31, 2024.

Private equity players are also participating in the speedy pace of M&A in a big way. Some through exits with secondary sales to other private companies.

Cement is one more sector suitable for M&A. Cement capacity was hanging around 68 per cent previously, now it is running at 85 per cent and thus the companies will continue to seek growth, organic or inorganic. The biggest player Ultratech has grown principally through mergers. Shree cement, Dalmiya cement have invested through building capacities and in case of Dalmiya cement through merging its group companies. By virtue of this growth in capacity the regional players have become national players. The government's attention on infrastructure and the speedy development of roads, ports and housing would warrant plentiful demand for cement. The departure of Holcim and the entry of a new player of scale, the Adani group, could work as a catalyst for another consolidation round with the other large companies competing to build scale inorganically. Those cement companies with less than 10 million tonnes will be targeted for inorganic growth.

Top deals in cement sector in last 5-6 years			
Year	Seller	Buyers	Capacity mtpa
2016	Jaypee Cement	UltraTech	21.2
2016	Reliance Cement	Birla Corp	5.6
2016	Lafarge India	Nirma / Nuvoco	11.0
2018	Century Cement	UltraTech	14.6
2018	Binani Cement	UltraTech	6.3
2020	Emami Cement	Nirma / Nuvoco	8.3

Source: Marketsmojo.com

Holcim had been managing both ACC and Ambuja Cements for the last one decade and in the process, refined these world class assets with good global practices. The assets would certainly be valuable to any owner, with a combined capacity of 70MT at one go. To begin with there were two serious contenders when Holcim publicized its plans of selling out. Sajjan Jindal of JSW Steel and Gautam Adani[vii].In the highly competitive markets, size does matters, particularly today in cement segment where the margins are wafer thin and companies are looking forward to economies of scale. In the national cement market UltraTech is number one followed by Adani.

Adani's prevailing businesses will be able to build anexceptionally integrated and differentiated business model and set up for a substantial capacity expansion. The group is likely to raise the capacity to 100 MTPA from current 70 MTPA. Adani has been building assets across the infrastructure space. Be it in mining or power, green or thermal, city gas pipelines, distribution of power, trading (with coal being the biggest commodity traded), food grains, construction, property development, and now cement. The synergies are visible. The utilization of coal ash from power plants, multi-modal transport through ports and uninterrupted supply of coal and power from other companies in the portfolio. The drivers for the decision to acquire Holcim are based on two primary factors, the demand supply gap and the synergies with existing businesses[viii].There would be consolidation and thus economies of scale will come into picture. Cement being a regional business, the cost-efficient players with reputed local brands will nevertheless always remain viable.

As has been noted earlier the M&A motives are multiple. India, by means of one of the dissolutely rising digital economies and digitally emerging healthcare sector, is on an exponential growth course, attending the demand to enhance quality, availability and convenience – be it in ordering medicines online, tele-consultation, or now diagnostics. During the pandemic there was an alteration not only in

consumer preferences, but also the business style and modus operandi by all the stake holders like doctors, hospitals, pharmacies and clinics across the country. It is not surprising that two of the leading firms look for synergy in the opportunity. One of the driving forces is the anticipated synergy in operations. For instance,the collaboration between PharmEasy and Thyrocare is exceptional and transformative for the Indian healthcare sector, consumer and the entire healthcare ecosystem. The synergies of both India's largest digital health platform and one of the largest, cost-effective diagnostic solution providers by volume will re-imagine and accelerate the delivery of high-quality diagnostic and OPD services across the full continuum of patient care to nearly 800 million Indians[ix].
In the highly competitive business landscape, for the companies to grow, the organic growth is hard to come because of multiple factors. The greenfield projects are time consuming, making consolidation and growth through M&A a preferred route. M&A have thus become more logical, if not inevitable for growth of an organization.

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[iv] Survey conducted by U.S. Federal Trade Commission (1955).
[v]Daksesh Parikh (2022), Season of mergers, Business India April 18 – May 1
[vi] Ibid
[vii] Daksesh Parikh and Sajal Bose (2022) Adani's biggest bet, Business India May 16-29
[viii] Ibid
[ix] Lancelot Joseph (2021), Reshaping healthcare, Business India June 28 – July 11