Indian Companies Are on an Acquisition Spree: Their Target? U.S. Firms

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Reliance Gateway Net, VSNL, Scandent and GHCL aren't exactly household names in the U.S., but they may be signs of bigger things to come.

These are only a few of the growing number of Indian businesses that have acquired U.S. firms in the past few years. And the U.S. merger-and-acquisition activity is just part of a bigger picture. Indian companies -- usually quietly, but sometimes with media fanfare -- have been on a buying spree in continental Europe, Great Britain and Asia in attempts to become key players in global markets.

What accounts for all the M&A activity? Faculty members at Wharton and a New York investment banker who is advising an Indian firm on the acquisition of a chain of U.S. jewelry stores point to a combination of factors -- means, motive, confidence and opportunity.

"Over the last decade, Indian firms in various industries -- most visibly in information technology but also in areas like auto components, the energy sector and [food products] -- have been slowly building up to become emerging multinationals," says Wharton management professor Saikat Chaudhuri. The outsourcing phenomenon, in which Western firms have hired Indian companies for call center work and other tasks, has reaped benefits for Indian managers, exposing them to Western companies and management practices and, at the same time, demonstrating to non-Indian firms that India is a reliable source of low-cost, yet high quality, products and services.

Moreover, Indian firms are becoming more profitable -- the result, in part, of an ever-booming economy -- and can access significantly more capital than in the past. "Incomes have grown phenomenally in some companies in some sectors," says Anil Kumar, managing partner at Virtus Global Partners, an investment and advisory firm with offices in the U. S. and India. "But the biggest factor [in the growth of acquisition activity] is that suddenly, there's a lot more cash available in the Indian market than earlier on. Many companies are underleveraged; they don't have much debt. Their capacity to borrow from others is a lot better. They can borrow sizeable amounts of cash, which can be deployed for acquisitions."

A number of Indian firms see global markets, not the domestic market, as their chief pathway to growth. "If you are a large company, you have to have a good presence in the U.S," Kumar notes. Another factor: "India is much more confident now. Companies are taking a lot more risk than earlier on." Astute managers, he adds, "are realizing that taking on risk [can be] a good thing."

In addition, regulatory changes in India have made it easier for firms to acquire overseas companies. For example, World Trade Organization rules governing quotas on the importation of textiles into developed countries were lifted in 2005, sparking an increase in the ability of Indian firms to produce apparel for non-Indian markets, according to Kumar.

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There is also an element of pride in Indian firms being able to make acquisitions in America, Kumar notes. "It means [Indian companies] have come of age and are better managed than they were 10 years ago. To acquire U.S. companies, you need to ... have a good capital base and fundamentals in place. This is a sign that India companies can truly compete on a global basis."

Jagmohan S. Raju, a Wharton marketing professor, says that restrictions imposed by New Delhi on the amount of foreign exchange that was allowed to enter India have also been relaxed. "Now the country is flush with foreign exchange. Indian companies [that have acquired overseas firms] sell products in dollars and take part of that money to India, some of which ends up in government coffers."

Yet another factor spurring the acquisition spree: Indian companies have greater power to raise money in U.S. capital markets because investors have grown more familiar with businesses in India, says Raju, adding that in general, the increase in acquisition activity has less to do with the Indian government proactively encouraging it than with the government removing barriers to M&A deals. "The roadblocks are gone," he says.

An Array of Acquisitions

The increased interest in U.S. acquisitions by Indian firms comes against a broader backdrop of accelerated acquisitions by Corporate India of companies in many places. In the first nine months of 2006, for example, Indian companies announced 115 foreign acquisitions with a value totaling $7.4 billion, according to *The Economist*. That is roughly a seven-fold increase from 2000.

A report by Grant Thornton India shows that the largest proportion of outbound deals (Indian companies acquiring international companies) in 2005 occurred in Europe (50% of deal value), followed by North America (24% of deal value). The report says that the IT sector saw the lion's share of outbound M&A deals in 2005, with 23% of the total number of international acquisitions, followed by pharmaceuticals/healthcare/biotech (14%). As for deal value, telecommunications led the way with a 33.6% share of deal value, followed by energy (14%), IT (8%) and steel (6.5%).

The Grant Thornton India report notes three significant trends in cross-border M&A activity by Indian firms in 2005. First, more than half the deals were cross-border: 58% of deal value, amounting to $9.5 billion, and 56% of deal volume at 192 deals. Second, there were more outbound deals than inbound deals both in value and volume terms. Third, while Indian companies "have acquired several businesses overseas to get an international footprint, most of these outbound deals have been lower volume deals, showing that Indian businesses are treading carefully and minimizing their risks through value buys."

One major U.S. acquisition took place in February 2006 when GHCL, based in the state of Gujarat, India, acquired Dan River, a Danville, Va.-based maker of home textiles for $93 million ($17 million in cash and the assumption of $76 million in debt).

Kumar calls the Dan River deal precedent-setting in that it may inspire other Indian companies to look for turnaround situations in their quest for U.S. acquisition targets. "Many companies have robust management and great operations but their industry is not doing well -- for example, the textile industry," Kumar notes, adding that Dan River had many mills inside the U.S., but was facing significant challenges and was competing with low-cost providers outside the country. "GHCL bought Dan River for more than $90 million, shut factories and started sourcing [its raw materials] from India. A year later, Dan River is doing a lot better. It turned a profit in October."

Also making major moves in 2006 were members of the Tata Group, a major Mumbai-based conglomerate with interests in, among other things, steel production, transportation, software and hotels. In June, Tata Coffee paid $220 million to buy Eight O'Clock Coffee, a venerable U.S. brand. In August, Tata Tea paid $677 million for a 30% stake in Glaceau, a maker of vitamin water in Whitestone, N.Y.

According to statistics compiled by the Mape Advisory Group, there were a number of noteworthy acquisitions by Indian companies of U.S. firms from January 2000 to March 2006. They include: Reliance Gateway Net's acquisition of Flag Telecom in 2003 for $191.2 million; the purchase by Mumbai-based VSNL of Tyco Global Network, a submarine cable network, from Tyco International, based in New Jersey, for $130 million in 2004; and the acquisition by Bangalore-based Scandent of Cambridge Services Holding, a global outsourcing firm headquartered in Greenwich, Conn., in 2005 for

$120 million.

Diamonds: A Dealmaker's Best Friend

Many of Corporate India's cross-border acquisitions have involved such stalwarts as chemicals, IT, steel and pharmaceuticals. But sometimes action in the M&A space can take a glamorous turn: Kumar is currently advising an Indian company in its negotiations to buy a chain of 100 U.S. jewelry stores. Kumar declined to identify the firms involved, but agreed to discuss the reasons for the Indian company's interest in making a U.S. acquisition.

India has long been known as a center for the cutting, polishing and manufacturing of quality diamond jewelry, which is sold to retail stores worldwide. Today, Indian companies are increasingly moving into the area of jewelry design. But India's diamond experts have worked largely behind the scenes, away from the eye of consumers. The acquirer Kumar is advising, however, would be able to place its name front and center before U.S. jewelry customers. The U.S. jewelry market is divided roughly into thirds among retailers. Department stores hold about 38% of the market, while mall chains like Zales have 35% market share and independent stores the remainder, Kumar says.

Competition in the diamond business is intensifying, and branding is one way to differentiate oneself. "China is becoming big competition for Indian companies," according to Kumar. "So Indian companies are saying, 'How do we go up the value chain?' Branding is one way to do that for customers who buy from Tiffanys and Zale's as opposed to an outlet store."

Kumar's client also is looking to increase its profit margins and improve its pricing power over what it sells. "You do this by selling [directly] to customers," he says. "This is the question our company has been facing. It's hard for them to compete with up-and-coming value-diamond suppliers. So they said, 'Maybe [it would be better] if we were right in front of a customer by buying a chain that will help us increase margins in our business.'" Kumar says the chain being acquired is a well-known brand, which allows them to charge higher prices than sellers of value-diamonds.

The goal of the acquiring firm is to keep the management of the acquired chain intact. "They will not try to shake the tree," says Kumar. "U.S. companies tend to shake the tree right away. Many times that's why mergers fail in the U.S."

Post-Merger Integration

Indeed, Indian companies may be excited about their cross-border shopping spree, but Wharton management professor Raphael (Raffi) Amit, says enthusiasm is no guarantee of a successful merger.

"Whenever companies in India, Korea, Israel or anywhere [do cross-border acquisitions], the problems they encounter are a different culture, different managerial norms, different compensation and a different regulatory environment," Amit says. "Unfortunately, the literature shows companies don't pay sufficient attention before the merger to the post-merger integration (PMI) issues that need to be addressed. PMI is a major barrier that firms face as they try to operate as one entity."

Amit's advice to Indian companies considering cross-border mergers would be to "pay close attention to the issues associated with PMI before agreeing to buy a company. That relates to understanding the strategic considerations and the merits of such an acquisition; market considerations that relate to the process by which companies agree on the terms of the acquisition; and post-acquisition issues that deal with the degree and scope of the integration, compensation for executives and managerial-norm issues."

Looking ahead, Kumar of Virtus Global Partners sees cross-border deals by Indian firms increasing in number and changing in nature. "Only the big deals get mentioned in the newspapers, but there are a lot of small- and mid-sized opportunities going on [in the $20 million to $60 million range]," he says. "We see a lot of those happening in the next four or five years." Kumar predicts more M&A activity in industrial products, packaging, auto components and textiles.

Wharton's Chaudhuri says that, like the diamond company being advised by Kumar, Indian companies in many sectors will, in years to come, seek out acquisitions that help them move up the value chain.

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"Look at pharmaceuticals," Chaudhuri explains. "Everybody's doing so much research and development in India you can imagine they're trying to come up with their own independent, research-driven drugs that could be blockbusters worldwide. You can make the same point about high quality, skilled people [in the diamond business]. In the IT sector, the future will also see firms moving up the value chain by doing more consulting work."

Chaudhuri adds that India's confidence in pursuing such deals will continue to strengthen. "The success that has been enjoyed so far has been due to self-confidence. That will only increase over time. In fact, we now see a reverse brain drain taking place. People who left are going back to India to start up firms or head the Indian operations of multinational corporations."

Corporate India, as it accelerates its cross-border acquisitions in years to come, will resemble China Inc. Says Chaudhuri: "Look at the amount of capital going into India and how the accounting and governance practices of the West are being adopted in India, like they are in China, and how Indian investors perceive opportunities in foreign markets. There's an analogy between Indian and Chinese companies. My prediction is 15 to 20 years from now, Indian and Chinese firms will compete with Western firms in all sectors around the world. It's good for everybody. It's part of the integration of the global economy, and it's important for India to participate in that."

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