A new order of financing investments: Evidence from acquisitions by India's listed firms

A Discussion

Vimal Balasubramaniam
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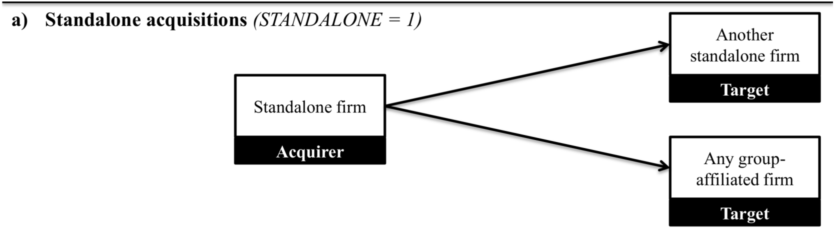
WARWICK
THE UNIVERSITY OF WARWICK

The Big Picture
Corporate control and financing investments

- Do firms have systematic preferences for means of financing investments?
- Modigliani and Miller (1958): Means of financing irrelevant.
- Harris and Raviv (1988): Existence of financing preferences that centers around managers' incentive to maintain control over the corporation.
- Amihud, Lev, Travlos (1990): Corporate insiders who value control will use cash/debt, than stock.
- More recent papers (Gu and Reed, 2016, for e.g.) show that ownership and control influences financing choices.

This paper

Characterise business-groups financing preferences



The Big Picture
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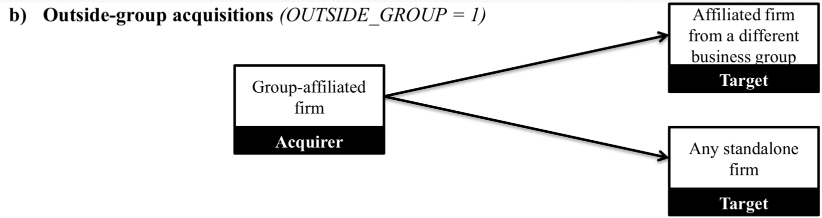
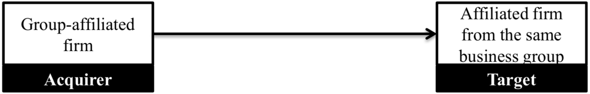


The Big Picture
Characterise business-groups financing preferences

c) Within-group acquisitions *(WITHIN_GROUP = 1)*



Why business-groups?

1. May value control differently from standalone firms.
2. Larger, and potentially less financially constrained than others.

Main findings:

- Group-affiliated bidders use equity to finance inter-group acquisitions.
- Group-affiliated bidders use cash/debt to finance outside-group acquisitions.
- Standalone bidders financing choices lie between this spectrum.

Suggestions I

1. Work-horse specification:

$$Prob(Equity_i = 1) = \alpha + \beta_1 \mathsf{WITHIN}_i + \beta_2 \mathsf{OUTSIDE}_i + \gamma' X_i + \epsilon_i$$

2. How different are firms that belong to business groups from standalone firms on observable characteristics?

3. Need to isolate variation to being a group-affiliated firm:
   - Advanced matching methods are reliable with small samples (N=360).
   - Currently β_1 and β_2 is identified assuming that firms are reasonably similar in other dimensions, other than being group-affiliated.
   - Example: Reliance or the Tatas have no similar standalone firms in India.

Suggestions II

4. How many of the acquisitions belong to the same set of business groups, or the same set of firms acquiring others?
5. This is important because it would be ideal to know if the observed effect size is a firm-specific preference, or a group-wide preference.
6. Why? Example: TCS is the jewel in the crown (cash flows) for the Tata Group. I wonder if the Tata Group would be happy if a non-TCS firm within the group uses stocks to acquire another firm.
7. You look at the health of the target firm (to rule out propping argument), but what about the health of the acquiring firm within the group?

Suggestions III

8. The paper does well in documenting the observed effect.
9. It will be important to ask the question, *why* is this the group-affiliated firm's preference?
10. Authors rule out propping, and tunneling convincingly.
11. If not propping, or tunneling, what can explain the preference?
    - Cash or debt vs. stocks don't change control for business groups with within-group acquisition.
    - Does a great job of explaining difference in preference between within and outside group acquisitions.
12. Why not prefer cash/debt than stock for a within-group acquisition?

Suggestions IV

13. Either the Modigliani-Miller world is not very distant a reality for business groups?
14. Or it is all about the cost of capital to achieve control.
    - Outside-group acquisition: Marginal costs of borrowing to acquire, lower than the benefit of acquiring the firm.
    - Inside-group acquisition: Marginal costs of borrowing to acquire may not be lower than the benefit of acquiring the firm!
15. Especially in poorly developed financial markets ecosystem – something that is highly correlated with the prevalance of business-groups!