Are Payment Method and Financing Decision of Mergers and Acquisitions Related? Evidence from Indian Corporates

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ABSTRACT

Mergers and Acquisitions (M&As) have been a global phenomenon in corporate world yet there is still scope to broaden our current understanding on the subject including the choice of payment. The financing decision also affects an acquirer’s ownership structure, financial leverage and subsequent decisions. The choice of investment financing is an important decision in the field of corporate finance. Mergers and acquisitions offer an appropriate framework to study the interaction between investment and financing decisions. Do corporates have systematic preferences for the means of financing investments especially in case of corporate acquisitions? In an acquisition, the acquirer can pay the claims of the target firm shareholders either by paying cash or by issuing stock or by a combination of both cash and stock. The study examines the financing decision involved in 1041 corporate acquisitions undertaken during the period 2000-2017. The study is based on a unique database compiled from SDC Thompson, S&P Capital IQ, Prowess, Capitaline and annual reports. Multinomial logit and nested logit models have been used to examine the factors affecting the acquirer’s choice of the financing sources. The study observes that size has an impact on the method of payment in case of cash Payment. A positive relationship is found between relative size and cash payment. As the relative size of the acquisition increases, cash payment becomes more likely and debt financing is preferred. For the characteristics of the acquisition, we find that an increase in tender offers leads to greater payments in cash. The findings also report that there is an increase in cross-border deals for the case of cash and mixed Payment. These empirical results of the nested logit results show that the decisions on the means of payment and on the sources of financing are determined by the different factors. The findings of this study are in line with the pecking order theory and the cost of capital considerations. When the firms have more cash with it than necessary, then there is an increase in cash/transaction value with increase in cash payment over stock payment. Acquirers are also found to use mixed Payment method, when there is a lack of cash with acquirer. The financial variables such as acquirers’ cash flow, leverage, Tobin Q are found to not have a very significant impact on the debt Payment. Cash is found to have positively affected by acquirers’ cash flow.

Keywords: Cross-border; Event Study; Multinomial logit; Tender offer; Tobin Q