Chapter 2
Strategic Flexibility Through Cross-Border Acquisitions: Market Response in Indian Context

Samta Jain, Smita Kashiramka and P. K. Jain

Abstract The global business organizations are virtually bound to possess strategic flexibility to confront the prevalent economic settings characterized by high volatility and fierce competition. Viewed from this perspective, cross-border acquisitions have become a critical constituent of expansion strategies for corporates, especially in emerging economies. This chapter proposes to evaluate the behavior of capital market around the announcement of international takeovers by firms from emerging economies. To meet these objectives, 110 overseas mergers undertaken by Indian companies over the period from 2012 to 2015 constitute the sample of the study. It has been observed that bidders, on an average, earn positive and statistically significant abnormal returns of 0.49% on the event day. Also, cumulative average abnormal returns (CAAR) examined over alternative period windows indicate significant value creation for Indian bidders. Moreover, the gains are more pronounced when the acquired firm is based in developed markets. This research work endeavors to enhance the understanding of cross-border acquisitions (CBAs) by enterprises from emerging markets (like India).

Keywords Cross-border acquisitions · Developed markets · Emerging markets · Event study India · Share price performance

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P. K. Suri and R. Yadav (eds.), *Transforming Organizations Through Flexible Systems Management*, Flexible Systems Management, https://doi.org/10.1007/978-981-13-9640-3_2

2.1 Introduction

The liberalization and globalization of financial markets, fierce competition, and technological developments have made business organizations vulnerable to volatile, uncertain, chaotic, and ambiguous (VUCA) environment (Sushil 2017a). To manage these threats effectively, firms perforce are compelled to be flexible and competent for their strategic processes (Hina et al. 2016). Firms have to move away from the clutches of rigidity and create flexible organizations.

As a concept, flexibility may be defined in terms of access to various options, change mechanisms in various processes/strategies, and freedom of choice (Sushil 2017a, b). In today's turbulent and unpredictable environment, maintaining a competitive advantage with only one option has become an arduous task for business firms. Thus, organizations from emerging economies are exploring multiple options by venturing into overseas transactions.

Exhibiting strategic flexibility, corporates in emerging nations have been rigorously involved in cross-border mergers to make their presence felt at the global level. As a result, there has been a sharp increase in outflow of foreign direct investments (FDI) from developing economies. As per the World Investment Report, developing markets have been the source of 39% of the total outbound FDI, recording an unprecedented level of US$454; 15 years ago, emerging economies contributed only 7% (UNCTAD 2014). In addition, UNCTAD (2014) also reported that there had been an increase in CBAs undertaken by emerging markets with a steep rise in 1 year from US$63 billion to US$109 billion.

Apropos to this, the overseas acquisition has developed as an inevitable ingredient of the expansion strategies by Indian firms seeking diversification of operations and quick access to international markets. These strategic decisions improve the geographical and operational flexibility by allowing firms to develop a network of businesses across various geographies. Since the 1990s with the liberalization and privatization of the Indian economy, Indian companies have been making huge investments in foreign markets to expand their operations across national boundaries.

Figure 2.1 exhibits that the number of CBAs completed by Indian firms has shown, by and large, an increasing trend during 2000–2010. The global financial crisis in 2008 caused a sudden plunge in the number of overseas transactions that regained its momentum in 2010. Since 2010, CBAs have shown an upward trend with 40,400 deals amounting to $3.5 trillion being transacted in 2014 (Swaminathan et al. 2014).

Hitherto, by and large, the literature focusing on mergers and acquisitions (M&As) in the management domain has evolved in developed markets. Filling the void, this academic work seeks to widen the existing knowledge on mergers and acquisitions by analyzing the performance of Indian bidders in terms of the movement in their share price consequent to the occurrence of the event. India, being one of the fastest and largest emerging economies, has been taken as the representative country. Moreover, to understand the pattern of value creation, a disaggregated analysis has also been performed based on the development status of the target country(developed/emerging).

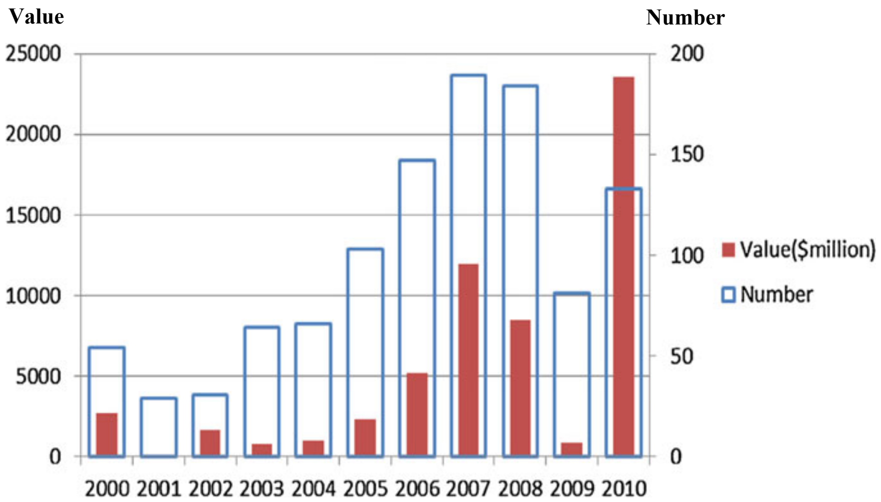

Fig. 2.1 Cross-border acquisitions completed over 2000–2010 by Indian firms. *Source* Nicholson and Salaber (2013)

The remaining chapter has been structured in five sections (including Sect. 2.1). Section 2.2 reports the existing studies and their findings. Section 2.3 describes the methodology and the data used in the study followed by Sect. 2.4 comprising the empirical results and discussion thereof. Lastly, Sect. 2.5 contains the concluding observations.

2.2 Literature Review

A substantial amount of academic studies has been carried out for analyzing the performance of cross-border acquisitions in virtually all domains of management. But most of the studies have evolved in the context of developed economies; the studies in the context of emerging economies provide mixed evidence on the subject. Put differently, whether such strategic decisions successfully increase the market value of bidders or not remains unanswered. Some of these studies indicate significant and positive returns to the acquirers' shareholders, while others point to wealth diminution. Also, there is disagreement concerning the measures used to analyze the performance of cross-border acquisitions. Several scholars have examined synergy gains from cross-border acquisitions in terms of abnormal stock market returns(Gubbi et al. 2010; Rani et al. 2012, 2015; Duppati and Rao 2015; Jain et al. 2017, 2018a, b) in the short-run, while a few researchers focus on long-term performance analysis in terms of financial ratios (Narayan and Thenmozhi 2014). Mittal and Jain (2012) have employed an integrated model, comprising both strategic and financial measures of performance, to assess the acquisition performance.

The principal idea behind the present chapter is to analyze the magnitude of wealth enhancement or erosion for the acquiring entities involved in the process of transnational acquisition activities. Gubbi et al. (2010) and Rani et al. (2015) have reported nonnegative abnormal returns(ARs) with the minimal probability of being insignificant for the Indian acquirers. Further, they noted returns to be relatively higher when target companies happen to be from developed markets. They cited acquisition of strategic and intangible resources including advanced technology, brands, distribution channels, etc., to be the drivers of value creation in CBAs. Rani et al. (2014), Duppati and Rao (2015), and Jain et al. (2017, 2018a, b) have exhibited a favorable market response to the announcement of CBAs by corporates from India.

Among studies involving multiple countries, Bhagat et al. (2011) have evaluated overseas acquisition announcement by the acquirers from emerging markets and observed abnormal returns (AR) of 1.09% which turned out to be statistically significant. On the contrary, Aybar and Ficici (2009) and Narayan and Thenmozhi (2014) have noted a considerable decline in the valuation of the bidders from emerging nations.

Based on the examination of international takeovers from developed economies, Corhay and Rad (2000); Uddin and Boateng (2009) and Cakici et al. (1996) exhibited statistically significant negative returns to the bidding entities. On the other hand, Aw and Chatterjee (2004); Conn et al. (2005); Kohli and Mann (2012) and Rani et al. (2014) have compared the performance of national and international mergers and reported mixed results.

Despite voluminous studies on mergers and acquisitions, the inquisitiveness of various stakeholders, viz., researchers, education intelligentsia, policy-makers, and senior executives about share market reaction to the announcement of CBAs by emerging economies, largely remains an unexplored field. This chapter, therefore, strives to make a valuable addition to the contemporary literature on mergers and acquisitions.

2.3 Data and Methodology

2.3.1 Data and Sample

Cross-border acquisitions announced and completed during 2012–2015 by the Indian companies listed on CNX Nifty 500 constitute the sample of the study. The period of 2011–2012 onward indicated an increasing trend regarding many cross-border acquisitions following the global financial crisis of 2008. Hence, the research period has been taken from 2012 to 2015. Further, preliminary data about the overseas acquisitions by Indian companies have been procured from Bloomberg, a comprehensive financial database with global coverage. For each deal, the database lists the dates of announcement and completion, names of the acquiring and the acquired company, the target country, and other deal-specific information.

Table 2.1 Industrial classification of the acquirers

Industry	Number of CBAs
Mining	8
Transportation, communications, electric, gas, and sanitary service industry	6
Manufacturing	58
Services	37
Wholesale commerce and trade	1
Total	110

Source Compiled by the author

The announcement dates of CBAs have also been manually confirmed with corporate announcements on national stock exchanges including Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). Further, event window around each announcement date has been scrutinized to control for any confounding effects per se major corporate events such as publication (announcement) of financial results and dividend declaration (McWilliams and Siegel 1997). The abovementioned processes about the announcement dates have been conducted to meet the demands of event study methodology. Furthermore, the stock must have been traded for at least 180 days before and 10 days after the event to form a valid sample. In this regard, daily-adjusted closing price and index data have been taken from Bloomberg.

The share price of any entity per se is affected by numerous elements happening both at micro- and macrolevels on a day-to-day basis. To eliminate their effects, the deals which have been noted to be affected by other relevant corporate events have been dropped from the analysis; data about these events have been collected from multiple sources including company websites, archival data at stock exchanges, business magazines, etc. The process yielded a final sample of 110 CBAs undertaken by Indian companies. Based on SIC codes, acquiring firms have been grouped into various industries as shown in Table 2.1.

Out of a total sample of 110 cross-border acquisitions, 82 transactions involved target firms located in developed economies (DE), while 28 deals involved target companies from emerging economies (EE). The target country has been bifurcated into developed or emerging market depending on its current membership status in the Organization for Economic Co-operation and Development (OECD) (Gubbi et al. 2010). Table 2.2 shows the geographic distribution of CBAs embarked upon by Indian companies during 2012–2015.

Table 2.2 Geographic distribution of the sample

Target country	Status*	Number of CBAs	Target country	Status*	Number of CBAs
Azerbaijan	EE	1	Luxembourg	DE	1
Australia	DE	3	Malaysia	EE	2
Brazil	EE	1	Mozambique	EE	1
Bahamas	DE	1	Oman	EE	1
Canada	DE	2	Philippines	EE	1
Chile	DE	1	Mexico	DE	1
Cameroon	EE	1	Netherlands	DE	1
China	EE	1	Sweden	DE	3
Cyprus	DE	1	Switzerland	DE	1
Croatia	EE	1	Turkey	DE	1
Denmark	DE	1	U.K.	DE	5
El Salvador	EE	1	U.S.	DE	38
Ethiopia	EE	1	Russia	EE	2
Finland	DE	1	Singapore	EE	5
France	DE	4	South Africa	EE	5
Germany	DE	12	U.A.E.	EE	1
Italy	DE	3	Uganda	EE	1
Liberia	EE	1	Vietnam	EE	1
Japan	DE	2	Total		110

Source Authors' compilation
*DE = developed economy; EE = emerging economy

2.3.2 Methodology

The valuation consequences of cross-border acquisition announcement for the acquiring firm have been evaluated using the standard event study methodology. According to Mackinlay (1997), the economic effect of any unanticipated corporate event for the firm can be quantified by analyzing the movement of its share price for a relatively short time period around the occurrence of the key event. It is because the equity price of an entity reflects the discounted sum of its expected future flow of returns. Thus, change in share price instead of any event (say acquisition) indicates the amount of additional returns (losses) that are likely to be earned (incurred) on account of the event. In the present chapter, the announcement of cross-border acquisition is the nodal event for study; the event date registered at the national stock exchange has been considered as the date of announcement of the event.

The critical issue in event study methodology is to compute the true counterfactual, that is to say, what would have been the normal returns had this acquisition not announced. It is a general practice to use the market model(Fama 1976; Brown and

Warner 1980, 1985; Kothari and Warner 1997) to estimate the normal (expected) returns. Given the conditions of market efficiency and rational investors, the market model establishes that the return on security at time ‘t’ (R_{it}) is directly proportional to market index return (R_{mt}) as depicted in Eq. (2.1)

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it} \quad (2.1)$$

where ε_{it} is the anomaly distributed error term.

The “normal return” for each acquisition has been estimated with over 150 trading days, comprising a window of 180 to 30 days before the announcement date. The parameters of the market model(α_i and β_i) are estimated using the ordinary least squares (OLS) method of regression. These computed values of parameters are fitted in Eq. (2.1) to get the estimated return $\left(\widehat{R}_{it}\right)$.

The change in share price on account of the observed event, that is, the abnormal return caused by the acquisition announcement is measured using Eq. (2.2)

$$AR_{it} = R_{it} - \left(\hat{\alpha} + \hat{\beta} R_{mt}\right) \quad (2.2)$$

where R_{it} is the observed or actual return.

These single-day abnormal returns are further aggregated cross-sectionally to yield “average abnormal return” (AARs) as indicated by Eq. (2.3):

$$AAR_t = \frac{1}{N}\sum_{i=1}^{N} AR_{it} \quad (2.3)$$

where N represents the number of CBAs.

Later on, to gauge the complete impact of the acquisition event, daily abnormal returns are aggregated cross-sectionally as well as across a specified period (called as “event window”) to obtain “cumulative average abnormal returns” as given in Eq. (2.4):

$$CAAR(t_1,\ t_2) = \sum_{t1}^{t2} AAR_t \quad (2.4)$$

where t_1 and t_2 indicate the beginning and ending, respectively, of the event window. For instance, for an event window of 7(−3, +3) days, $t_1 = -3$ and $t_2 = +3$.

Abnormal returns have been computed for alternative windows 3 (−1, +1) days, 7 (−3, +3) days, and 11(−5, +5) days around the event date; this has been done to take into account any leakage effect prior to the formal announcement as well as the factor of inefficiency especially in developing markets such as India, thereby, achieving reliable outcome.

The hypotheses to be tested are as follows:

H_{01}: There are no AAR on the CBAs announcement.

H_{02}: There are no CAAR on the CBAs announcement.

In the event study methodology, parametric tests complement nonparametric tests to check for the significance of abnormal returns. Accordingly, the present study has used a t-test, a parametric test, and generalized sign test, a nonparametric test to obtain robust findings which are invariant to the presence of outliers.

2.4 Results and Discussion

Tables 2.3 and 2.4 illustrate the abnormal returns (AR) gained by the shareholders of Indian companies bidding for overseas organizations. Table 2.3 reports the average abnormal returns (AAR) on the announcement day in addition to the ratio of positive and negative average abnormal return, while cumulative average abnormal returns (CAAR) along with the proportion of positive and negative cumulative abnormal returns have been summarized in Table 2.4. Moreover, the results of parametric and nonparametric tests performed to ensure the robustness of returns have also been presented in Tables 2.3 and 2.4.

Table 2.3 enumerates that shareholders earn positive abnormal returns of 0.49% on the day of announcement of cross-border acquisitions; the results come out to be significant at 5%. Nearly, 60% of the deals has produced nonnegative and significant valuation effects for the Indian bidders. Besides, the acquiring firms have also experienced positive cumulative abnormal returns invariant to different event windows, viz., (−1, +1), (−3, +3), and (−5, +5); significant returns (at 5%) have

Table 2.3 Overall average abnormal returns to acquirers over 11 days (−5, +5) event window, 2012–2015

Days	AR (%)	t-test	Pos:Neg AR	Generalized sign Z
−5	0.29	1.4164	51:59	−0.1744
−4	0.13	0.8424	53:57	0.2075
−3	0.04	0.2178	52:58	0.0166
−2	−0.09	−0.5153	45:65	−1.3204
−1	0.13	0.7449	58:52	1.1625
0	0.49	2.0862**	64:46	2.3085**
1	0.34	1.3236	60:50	1.5445
2	−0.17	−0.7937	48:62	−0.7474
3	−0.35	−1.7386	42:68	−1.8934
4	0.40	1.3841	55:55	0.5895
5	0.24	1.26	63:47	2.1175

Source Author's computation
Note ***, ** and * at 1, 5, and 10% level of significance

Table 2.4 Cumulative abnormal average returns (CAAR) of Indian bidders over different event windows, 2012–2015

Event window	CAAR (%)	t-test	Pos:Neg CAR	Generalized sign Z
(−1, 1)	0.97	2.4452**	66:44	2.6905**
(−3, 3)	0.39	0.7305	52:58	0.0166
(−5, 5)	1.46	2.0144**	63:47	2.1175**

Source Author's computation
*Note****, ** and *at 1, 5, and 10% level of significance

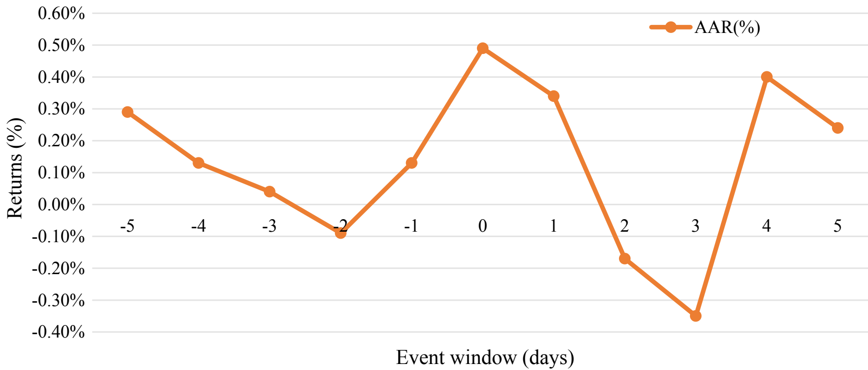

Fig. 2.2 AAR of Indian acquirers over 11(−5, +5) days event window, 2012–2015. *Source* Authors'analysis

been noted for 3 (−1, +1) days and 11 (−5, +5) days windows. These findings are in concurrence with those of Gubbi et al. (2010), Bhagat et al. (2011) and Rani et al. (2015).

Figures 2.2 and 2.3 demonstrate the pattern of average abnormal returns (AAR) and cumulative abnormal returns (CAR) observed during 11 days (−5, +5) event window. As depicted in the graph, abnormal returns begin to show an increasing trend from 2 days before to 2 days after the focal event, yielding the highest return on the day of the announcement.

The impact of the development status (developed/emerging) of the acquired firm's country on the value of the acquiring firm has been compared in Table 2.5. Empirical findings indicate that bidding for a target firm located in developed markets vis-à-vis emerging economies yields higher and statistically significant returns of 1.29% and 1.63% over 3 days (−1, +1) and 5 days (−5, +5) event window. Equally revealing to note is that acquisition of a target firm based on emerging economies also provides positive albeit not statistically significant returns to the bidders during distinct event windows. These findings are similar to the results reported by Rani et al. (2015).

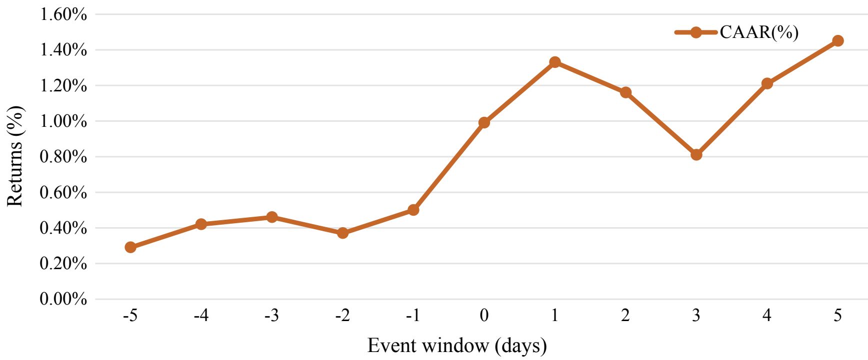

Fig. 2.3 CAAR of Indian acquirers over 11(−5, +5) days event window, 2012–2015. *Source* Authors' analysis

Table 2.5 Development status of the target country and CAAR for Indian acquirers over multiple event windows, 2012–2015

Event window	CAR (%)		t-test		Pos:Neg		Generalized sign Z	
	Developed	Emerging	Developed	Emerging	Developed	Emerging	Developed	Emerging
(−1, 1)	1.29	0.01	2.6016***	0.0175	51:31	15:13	2.8276***	0.4965
(−3, 3)	0.47	0.17	0.6859	0.2461	38:44	14:14	−0.0502	0.1185
(−5, 5)	1.63	0.95	1.8085*	0.8878	46:36	17:11	1.7208*	1.2526

Source Author's computation
Note ***, ** and * at 1, 5, and 10% level of significance

2.5 Conclusion

The existing volatile and chaotic business environment have pushed firms to be more flexible with respect to their strategic management process. With this in mind, the present study has evaluated the impact of the strategic transition from an organic approach to an inorganic mode of expansion across national boundaries. Firms from growing economies have increasingly been using cross-border acquisitions to gain competitive advantage and establish their foothold in the world economy. Moreover, such firms, as against acquirers from developed markets, are motivated by the desire to seek strategic resources rather than exploiting their existing resources and own proprietary knowledge and capabilities.

This academic work measures the market response in terms of share price reaction to the announcement of CBAs by Indian firms. Accordingly, the study attempts to find out whether such acquisitions enhance or destroy the wealth of the bidding firm shareholders. In addition, it has examined if the status of the target country has any significant impact on the returns of the acquirers. In other words, whether acquiring a target firm located in developed market generates more wealth for the acquirers *vis-a-vis* the target firm based on an emerging country.

The short-run share price performance of 110 CBAs announced and completed by Indian companies during 2012–2015 has been assessed. The event study methodology has been applied to evaluate the movement in stock price as a consequence of the announcement of CBAs. The empirical findings suggest that announcement of CBAs has positive wealth effects for the shareholders of the acquiring firms; acquirers experience nonnegative and statistically significant abnormal returns on the announcement day as well as significant and positive cumulative returns have been observed over multiple event windows. Furthermore, returns are higher for acquisition of targets in advanced *vis-à-vis* emerging economies.

Cross-border mergers are more likely to generate synergy gains resulting from economies of scale and scope. Scale economies improve the operational efficiency and flexibility of the firm, creating more benefits for the combined firm. Also, decreasing of risk through geographical diversification, tax benefits, and currency differentials could be the possible antecedents of value creation for the bidding firms.

Emerging market players, more often, venture into cross-border acquisitions with a desire to build and improve their competitive advantage and seek strategic and knowledge-based resources. Such strategic skills and capabilities including technical know-how, superior management skills, innovative attitude, advanced technology, established distribution channels, and natural resources are ingrained in the people, national and organizational culture, and community of the host nation.

Ghemawat (2001) has opined that the quality of assets available in a country is directly proportional to the level of economic development of that country. Hence, acquiring a firm located in advanced economies generates higher value for the bidders' shareholders. Furthermore, developed markets are characterized by stringent investor protection laws (Bhagat et al. 2011), higher governance standards (Khanna and Palepu 2004; Martynova and Renneboog 2008), low levels of corruption, and higher institutional development, encouraging acquirers to bootstrap themselves to higher standards, thus producing positive wealth effects for the shareholders.

The study is expected to provide invaluable insights into the management of firms from emerging economies in general and Indian firms in particular in the context of their overseas expansion strategies. Moreover, it can also have implications for the government and policy-makers of emerging economies while drafting regulations for outward foreign direct investments.

The study is restricted to the analysis of overseas transactions by Indian companies only. Moreover, the focus of the chapter is limited to the returns accruing to the acquiring firms only. This academic work can be extended to a larger number of emerging economies to throw more light on the pattern of risks and returns involved for the acquirer as well as the target firm.

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