

Mergers & Acquisitions in India: A sectoral analysis

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Keywords

M&A, Sectors, Financial Sector, Trends

Abstract

Globalization, deregulation and technological improvements have resulted in increase in M&A across the globe. There is enormous literature existing in the advanced economies. However, very little information is available regarding M&A in India. Various sectors have witnessed differential involvement in M&A activity indicating higher participation by some. Particularly, certain sectors such as financial services and pharmaceuticals demonstrate higher M&A activity. To emphasise differential importance of sectors in M&A activity, it is necessary to conduct a sector-wise analysis. Accordingly, this study attempts to investigate the differential representation of various sectors in M&A. Further, it explores the role played by India in the rising global M&A activity. In light of this, it specifies the factors driving consolidation in the financial sector globally.

1. Introduction

The changing policy framework associated with globalisation, deregulation and technology in most economies have contributed to increased competition and facilitated a global spurt in Merger and Acquisition (M&A)¹ activity (Berger, Demsetz and Strahan, 1999; Kohers *et al.*, 2000; Group of Ten Report, 2001; Amel *et al.*, 2004; How *et al.*, 2005; Beena, 2008). The rapid pace of consolidation among financial entities and the intense impact it could have on financial and economic stability has resulted in enormous literature in the advanced economies. However, very little information is available regarding M&A in Indian economy (for instance, Beena, 2001; Agarwal, 2006; Agarwal and Bhattacharjea, 2006; Kar, 2006; Mantravadi and Reddy, 2008; Jawa, 2009; Mishra & Chandra, 2010; Kaur, 2012). The present study attempts to fill this gap in literature. Specifically, the present study attempts to analyse the trends of M&A in various sectors with special focus on the financial sector in India.

Various sectors have witnessed differential involvement in M&A activity indicating higher participation by some (Agarwal and Bhattacharjea, 2006). Particularly, certain sectors such as financial services and pharmaceuticals have demonstrated higher M&A activity (Kumar, 2000; Kar, 2006 and Beena, 2008). One plausible reason for differential participation could be the provisions in the Income Tax Act which may not be uniformly available to all sectors. The relatively higher M&A activity could simply be due to larger number of firms in one industry relative to others (Agarwal and Bhattacharjea, 2006). To emphasise the differential importance of sectors in M&A activity, it is necessary to conduct a sector-wise analysis. Accordingly, this study attempts to investigate the differential representation of various sectors in M&A. Further, it explores the role played by India in the rising global M&A activity. In light of this, it also specifies the factors driving consolidation in the financial sector globally.

The study is organised as follows. Section II clarifies the concept of M&A. Section III outlines the trends and patterns of M&A in various sectors in India with special reference to the financial sector. Section IV provides the significance of financial sector in an economy in general and India in particular. Section V presents the factors leading to an increase in global M&A activity among the financial entities. Finally, Section VI concludes and draws some policy implications.

2. Mergers & Acquisitions: Conceptual Issues

In order to grow a firm could adopt two different (but complimentary) growth strategies: internal (or organic) and external (or inorganic)². A firm may resort to external restructuring strategies such as *M&A*, especially when the inherent growth of the firm slows down (Mueller, 1980). Accordingly, *M&A* are recognised worldwide as faster means to achieve various benefits including efficiency, market power, growth and diversification. These are means of unifying control through a transfer of ownership within two or more firms. In technical terms, while merger means creating a new entity, that is a combination of existing entities to achieve common objectives, acquisition refers to buying-out or acquiring stake in another company (Hopner and Jackson, 2006; Reuvid, 2007).

M&A are an important aspect of any corporate strategy and may occur in response to a variety of strategic, technological, economic or organizational factors. Joint ventures, strategic alliances and lately outsourcing are other forms through which firms can work together for a well defined set of objectives, activities or products but without commonly controlling the participating firms (Ramaswamy and Namakumari, 1999). These could be especially useful when there are certain hurdles (regulatory, cultural or others) prohibiting collaboration through *M&A*. If conditions work out well between the firms, then both joint ventures and strategic alliances could facilitate *M&A* among these firms (Hopner and Jackson, 2006; Reuvid, 2007; Kohn, 2009). If not, then such collaborations are relatively easy to dissolve relative to *M&A* (Kohn, 2009).

In simple terms, an acquisition may be defined as a transaction where one company buys the shares of another company by issuing its own shares, cash, debt or a mix of these (Reuvid, 2007). In other words, acquisition is a transaction where one firm purchases a stake of another firm (Group of 10 Report, 2001) through which they are likely to coordinate their strategies (Focarelli *et al.*, 2002). Alternatively, it may be defined as acquisition of a certain block of equity capital of a company, which enables the acquirer to exercise control over the affairs of the company thus acquired (Agarwal, 2002).

On the other hand, a merger is one in which two firms agree to combine their business to form a new company that issue shares which replace the shares of both businesses (Reuvid, 2007). Clearly, merger is a combination of two companies wherein at least one loses its corporate existence. The surviving company, also called the merged company, acquires both the assets and liabilities of the company that loses its existence (Agarwal, 2002). A merger could provide a greater degree of control relative to acquisitions, because the operations of both firms are combined into a single entity (Group of Ten Report, 2001). Nevertheless, the firms may enter into acquisitions due to operational, geographical or legal reasons to maintain separate corporate entities. Nonetheless, practically, the impact may not be of much difference in the two, as in both the control passes from one firm to another (Reuvid, 2007). Due to this similarity, many studies on *M&A* do not distinguish between these two methods of passing the control of ownership. Since the differences are only technical, the present study refers to all such business reorganisation measures as *M&A*. It should, however, be noted that the procedure for both merger and acquisition in India is completely different.

Friendly versus Hostile *M&A*: *M&A* among firms may be initiated in a friendly or hostile manner. A hostile (forced, unfriendly or unsolicited) takeover is defined as the acquisition by directly approaching the shareholders without taking consent of the target company's management. The hostile takeovers are rarely observed in most countries (Andrade *et al.*, 2001). These are virtually non-existent in India too. This may be due to both the presence of promoter

² A few studies have attempted to examine the interrelationship between internal and external (via *M&A*) growth in a firm. Luypaert (2007) provides an overview of the related literature.

families with dominant shareholding in most businesses (Mathew, 2007; Armour *et al.*, 2011) and the presence of corporate control by market regulator, Securities and Exchange Board of India (SEBI), which formulates rules and framework for orderly conduct of takeovers (Ramu, 1998; Banaji, 2005; Kaur, 2012). Further, in the context of financial entities, RBI imposes restrictions on acquisition financing in an attempt to make hostile takeovers difficult.

3. Trends of M&A in India

The existing studies have demonstrated that M&A activity in India gained momentum especially after the latter half of 1990s (Ramu, 1998; Basant, 2000; Kumar, 2000; Beena, 2001, 2008; Agarwal, 2002; Mohan, 2005; Kar, 2006; Jawa, 2009). These studies have been briefly summarised in Table 2. For instance, Basant (2000) investigates the nature, motives and industry-wise classification of mergers during 1991 to 1997. Kumar (2000) focuses on mergers among multinational enterprises in India during 1993 to 2000. Beena (2001) analysed the M&A activity in private corporate sector during 1972 to 1995. Based on the database compiled in her study, it was found that there were 291 M&A deals (236 mergers and 55 acquisitions) during 1990-95.

The study documents that the momentum in M&A activity has picked up since the latter half of 1990s. During the period 1995-2000, the M&A increased to 736 (425 mergers and 311 acquisitions). In another study, Agarwal (2002) compiled a database consisting of 2253 mergers. The study found that the number of mergers increased from 452 during 1990-95 to 1250 during 1996-2002. However, the study did not consider acquisitions. Moreover, the existing studies in India fail to provide an exclusive attention to the financial sector.

Table 2. Studies on Trends of M&A in India - A Brief Literature Survey

Study	Period	Objectives/Methodology/Findings
Ramu (1998)	1992-1997	The study dates the actual wave of M&A in India to have started from 1994. Although M&A have taken place prior to 1994, but they were not that widespread. Based on case studies of firms belonging to different sectors, the study identifies Pharmaceutical industry to be the most active player in M&A activity.
Kumar (2000)	1993-2000	The study explores the patterns and implications of foreign multinational enterprises (MNE) related M&A in India. It has been observed that the bulk of the deals relating to MNE have materialized since 1996, wherein acquisitions have outnumbered mergers. Moreover, an increasing proportion of such deals were in services sector.
Beena (2001)	1972-1995	The study analyses the role of mergers in the private corporate sector. A substantial growth of M&A has been witnessed since the 1990s. But the trend has been sharper since the latter half of 1990s.
Agarwal (2002)	1973-2002	The study identifies three phases of merger activity: low and stagnant (1973-74 to 1987-88); moderate (1988-89 to 1994-95) and high merger activity (1995-96 to 2001-03). The merger activity demonstrates a significant upward trend after 1995. However, the study considers only mergers and not acquisitions.
Kar (2006)	1990-2001	The study examines the trends associated with M&A of listed business enterprises in different sectors of India. It uses simple OLS technique and presents a comparative analysis of pre and post M&A performance.
Kumar and Rajib (2007)	1974-2005	The study indicates that India has been a late comer in the M&A process due to unfriendly regulations and restrictive laws. Based on their dataset, it was found that prior to liberalization, mergers outnumbered acquisitions, but post liberalization; it was the other way round.
Jawa (2009)	1997-2004	The study attempts to evaluate whether M&A have been able to generate value by comparing various measures of value creation. Similar to Ramu (1998), the study reports the actual wave of M&A in India to begin after 1994 when the necessity of formulating a new takeover code was felt by the

		regulating agencies like SEBI.
Satyanarayana & Manju (2011)	1998-2004	Based on INDATA survey data, the study documents that the M&A wave in India took place towards the end of mid 1990s. However, there has been substantial growth of M&A in 2000-01.
Kaur (2012)	2000-2005	The highest number of M&A deals was observed in the year 2000, after which it declined till 2004. Of the M&A deals during 2001-05, 40% of the deals were registered in services sector. Further, out of the merger deals during 2001-05, 60% of total merger activity had arisen in services sector within which financial sector occupied a major share. Of the total acquisitions, one-third took place in services within which financial sector, witnessed less than 10% share.

Source: Author's compilation

The common finding that can be drawn on the basis of existing studies is that the M&A activity in India increased after liberalisation, although it picked momentum only after mid 1990s. Accordingly, the analysis in the subsequent section is based on two periods: the slow growth phase (1996-2000) and the rapid growth phase (2000-08) in order to (1) explore the role of India in global M&A activity and (2) investigate the trends and pattern of M&A in India.

III.I Slow Growth Phase (Prior to 2000)

Role of India in Global M&A Activity: An international comparison of M&A activity in banking during 1990-99 has been made in the Group of Ten report³ (2001). The report reveals certain interesting facts. First, the 1990s, particularly latter few years, have been characterised by a high level of M&A activity (both number and value) in the financial sector. This indicates rising trend towards creation of big and complex financial institutions. Further, majority of M&A activity within the financial sector involved banking firms (60% in terms of number and 70% in terms of value of M&A). Furthermore, cross border M&A were found to be less frequent, especially involving firms in the same segment. The subsequent table (Table 3) reports the M&A activity.

Table 3. Mergers and Acquisitions in Banking, 1990-99

Country	Number		Value (US \$ bn)	
	1990-96	1997-99	1990-96	1997-99
United States	1607	970	190	507
Europe	799	427	95	231
Poland	124	580	NA	NA
Philippines	14	6	NA	7
Colombia	3	11	1	4
Malaysia	2	21	1	17
Singapore	1	5	18	146
Thailand	1	2	0	39
India	0	2	0	NA
Hong Kong	0	0	0	0
Korea	0	11	0	323

Source: Modified from Hawkins and Mihaljek (2001)

In the slow growth phase, India lags behind the advanced (such as U.S. and Europe) as well as emerging nations (such as Malaysia and Singapore), both in terms of number and value (Table 3). In advanced economies such as U.S. and Europe the value of these transactions has

³ To conduct this study, a working party was set up under the auspices of finance ministry and central bank deputies of Australia, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Switzerland, U.K. and U.S. and representatives from Bank of International Settlements, European Central Bank, European Commission, International Monetary Fund and the Organisation for Economic Co-operation and Development.

increased overtime. In contrast, during 1990-96, there was little M&A activity in Indian banking sector. In fact, it is only during 1997-99 that some M&A activity could be noticed.

Trend and Pattern of M&A in India: In the absence of readily available data, the analysis⁴ in the present section is based on the list of M&A provided in Kar (2006). Table 4 reports the number of M&A taking place in different sectors during 1996 to 2000.

Table 4. Sector-wise M&A Activity, Number and Share (% of total), 1996 – 2000

S.No.	Industry	Year					1996-2000	Share (%)
		1996	1997	1998	1999	2000		
1	Chemicals, Drugs and Fertilisers	17	49	31	63	25	185	14.8
2	Petrochemicals, Plastics, Rubber, Tyres, Tubes	3	12	11	13	10	49	3.9
3	Energy, Gas, Oil, Power & Allied Industries	5	11	11	23	14	64	5.1
4	Non Metallic Mineral products	3	8	12	19	8	50	4.0
5	Airlines, Travels, Hotel	4	8	3	14	4	33	2.6
6	Paper Products, Printing, Publishing, Media & entertainment	0	6	5	3	2	16	1.3
7	Food Products	9	12	9	18	13	61	4.9
8	Textiles, Wearing Apparel	2	4	11	8	7	32	2.6
9	Finance & Banking	0	24	36	46	30	136	10.9
10	IT & Telecom	5	15	29	46	50	145	11.6
11	Electrical & Electronics	4	13	8	15	11	51	4.1
12	Basic Metal, Alloy Industries, Metal Products & Parts	7	15	11	20	12	65	5.2
13	Mfg. of Machinery & Equipments other than Transport	8	25	27	31	13	104	8.3
14	Mfg. of Transport Machinery & Equipments & Spares	1	13	9	29	12	64	5.1
15	Tobacco, Beverages, Wine & Allied Products	0	4	2	5	5	16	1.3
16	Others	1	34	33	58	56	182	14.5
	All	69	253	248	411	272	1253	100.0

Source: Author's calculations based on list of M&A provided in Kar (2006)

During 1996 to 2000, 1253 M&A transactions took place in various sectors of India. Specifically, the M&A transactions increased from 69 in 1996 to 272 in 2000. The highest number of deals (more than 400) was observed in the year 1999 (Table 4).

On analysing sector-wise M&A deals, it can be seen that the highest involvement has been demonstrated by the firms belonging to chemicals, drugs and fertilizer industry. The firms in information technology (IT) & telecom and financial services are among the other active participants. In fact, a rising proportion of M&A activity is represented by the financial sector (Kumar, 2000). This sector has shown a persistent rise in the number of M&A from 1996 to 1999. It is only in the year 2000 that a decline has been observed, which is true for most of the other sectors as well. Moreover, it ranks first in the year 1998 and third during 1997, 1999 and 2000.

This increase in M&A observed in the financial services sector has been consistent with the forces of deregulation, globalisation and improvement in technology in financial services. On the contrary the firms in the tobacco, beverages, wine & allied products as well as paper products, printing, publishing, media & entertainment are less active in M&A activity (Table 4). In sum, it

⁴ The analysis is based on calendar year (i.e. January to December).

can be inferred that prior to 2000 the financial sector's share in the overall M&A activity in the economy started increasing and it emerged to be an important player in M&A.

III.2 Rapid Growth Phase (Post 2000)

Role of India in Global M&A Activity: In the post 2000 period, there has been a rise in global M&A activity. However, the pace of consolidation has been uneven due to various reasons such as different regulatory regimes across countries. Similar to the pre 2000 period, M&A activity in India during the post 2000 period has not been remarkable. An international comparison done by Armour (2011)⁵ provides evidence on comparison of M&A activity across developed (U.S., U.K. and Japan) and emerging economies (India, China and Brazil) (Table 5 & 6).

Table 5: Number and Value (\$ million) of M&A, 2000-09

Year	US		UK		Japan		India		China		Brazil	
	No.	Value	No.	Value	No.	Value	No.	Value	No.	Value	No.	Value
2000	811	1409395.07	297	364332.4	590	78676.2	189	3206.79	114	38009.0	256	25538.4
2001	585	654041.219	238	133946.4	565	31651.6	126	1755.63	146	7395.3	210	10099.8
2002	560	387059.722	197	121423.9	768	25503.5	119	1899.9	260	18163.8	125	7390.5
2003	618	479560.105	184	110112.8	904	52248.7	158	2141.2	352	15896.1	112	10704.0
2004	685	673750.626	199	210193.8	104	52306.7	156	2478.11	387	8270.61	129	9819.38
2005	769	966010.244	224	249763.7	119	94463.4	299	8094.05	381	6413.79	125	6380.15
2006	839	1242829.49	227	253322.1	113	51892.4	311	15371.4	414	15203.2	170	14672.6
2007	850	1164772.55	254	323964.4	151	72720.1	295	18090.6	513	26646.6	425	22581.6
2008	692	613736.475	203	176553.9	148	44535.4	350	10252.4	615	44183.1	454	57167.7
2009	543	483754.321	158	72344.9	138	51565.9	300	4937.78	423	22334.4	201	27428.0

Source: Armour (2011) based on SDC Thompson Database

Similar to the pre 2000 period, in the post 2000 period, the developed countries have demonstrated much higher involvement in M&A activity. Although, in terms of number there has not been a substantial difference in M&A activity among the emerging economies (Brazil, China and India), however, in terms of value, the M&A activity in India has not been highly impressive. This finding can also be observed from the following table (Table 6).

Table 6: Value of M&A Deals, 2000-08 (% of GDP)

Year	USA	UK	Japan	India	China	Brazil
2000	0.144334	0.246574	0.016856	0.006969	0.031714	0.039613
2001	0.064911	0.091065	0.007728	0.003674	0.005582	0.018245
2002	0.037154	0.075322	0.006509	0.003746	0.012494	0.014657
2003	0.043964	0.059174	0.012355	0.003572	0.009687	0.019375
2004	0.057928	0.095626	0.011356	0.003536	0.004282	0.014794

⁵ The author is greatly thankful to Prof. John Armour, Oxford University School of Law for sharing these tables in order to carry the analysis.

2005	0.07813	0.109537	0.020752	0.009991	0.002869	0.007232
2006	0.094753	0.104004	0.011895	0.016801	0.00572	0.013473
2007	0.084763	0.115559	0.016601	0.015372	0.007878	0.016937
2008	0.043548	0.066025	0.009069	0.008845	0.010211	0.036294

Source: Armour (2011) based on SDC Thompson Database and World Development Indicators (2009)

The core finding that emerge from the analysis is that relative to developed as well as some emerging economies, *M&A* activity (especially in terms of value) has not been extremely remarkable in India. Nevertheless, it is increasing overtime.

Trend and Pattern of *M&A* in India: The analysis in this section is based on information compiled from the *M&A* database of Centre for Monitoring Indian Economy (CMIE). Table 7 provides insights on the significance of various sectors in the *M&A* activity in the post 2000 period.

Table 7. Sector-wise *M&A* Activity, Number and Share (% of total), 2001- 2007⁶

S. No	Industry	Year							2001-2007	Share (%)
		2001	2002	2003	2004	2005	2006	2007		
1	Food, Tobacco & Beverages	105	90	82	70	58	72	46	523	6.4
2	Textiles	48	59	60	61	65	56	36	385	4.7
3	Chemicals, Plastics, Drugs, Fertilisers, Cosmetics, Petroleum products, Tyres and tubes	177	179	152	159	144	115	122	1048	12.8
4	Non Metallic mineral products	18	36	26	24	35	46	42	227	2.8
5	Metals & Metal Products	27	54	56	44	45	43	31	300	3.7
6	Machinery (Electrical & Non Electrical)	49	102	67	41	88	89	69	505	6.1
7	Automobiles & Automobile Ancillaries	40	36	45	36	40	33	37	267	3.2
8	Miscellaneous Manufacturing	34	44	27	33	28	25	36	227	2.8
19	Diversified	18	9	10	8	6	4	3	58	0.7
10	Mining	5	5	7	10	10	24	9	70	0.9
11	Electricity	11	13	16	9	10	13	8	80	1.0
12	Financial Services	171	227	160	106	209	191	154	1218	14.8
13	Other services	186	324	281	279	212	213	219	1714	20.9
	Total	1200	1325	1107	1003	1194	1322	1068	8219	100

Source: Author's calculations from *M&A* database, CMIE

Table 7 reports the *M&A* activity taking place in various sectors during the period 2001 to 2007. Based on a different data source on *M&A*, INDATA, compiled by a private firm named India Advisory Partners, Jawa (2009) found a remarkable increase in the value and number of deals in the year 2002 and a decline in 2003 (both consistent with figures in Table 7) but a little improvement in 2004. A comparison of Table 7 with Table 4 provides meaningful insights on the *M&A* activity in these sectors over time. While these tables are not strictly comparable due to different data sources used, nevertheless, useful insights can be drawn from this comparative analysis⁷. Further, it can be observed that, there has been a substantial increase in *M&A* taking place in post 2000 period. This is true for all the sectors. Interestingly, there were 1253 *M&A* in the slow growth period (1996-2000), only a little higher than that of *M&A* in the year 2001 alone. Although this could be attributed to different data sources, nevertheless, virtually all studies have

⁶ The analysis could not be extended beyond 2007-08 as the *M&A* database providing this information has been discontinued by CMIE.

⁷ In the pre 2000 period, the industries are classified into 17 groups, while, in the post 2000 period there are only 13 groups.

pointed to an increase in *M&A* during this period. Almost one fifth of *M&A* arise in the 'other services' sector, that includes hotel & tourism, recreational services, health services, trading, transport, communication, information technology and miscellaneous services (Table 7). This has been observed in other studies as well (Kumar, 2000). Moreover, the firms in services sector were actively involved in *M&A* during the pre-2000 period as well, wherein, these services were placed separately, such as Airlines, Travel & Hotels, IT & Telecom and other services (Table 4). If all these are merged in Table 4, 'other services' sector, would have occupied a significant share in the period 1996-2000 as well.

The second in importance is the financial services sector, which increased its share in overall *M&A* activity from 11% in pre 2000 period to almost 15% in the post 2000 period. The next in importance is the chemicals sector (13% in post 2000) consisting of plastics, drugs, fertilisers, cosmetics, petroleum products, tyres and tubes. This sector, reduced its share from 19% in pre 2000 period, wherein it occupied the highest share. In addition, it has been observed that there has not been a substantial change in some sectors such as food, tobacco and beverages and textiles; a decline in others such as pharmaceuticals, metal and metal products, non-metallic mineral products, machinery, automobiles and power; and an increase in financial services in the post 2000 period. The differential participation of various sectors in *M&A* activity may be explained by macroeconomic conditions such as growth, reform measures, government policy (e.g. deregulation, taxation, etc.) or the extent of potential benefits that firms perceive from *M&A*.

To summarise, the financial services has witnessed a significant and rising share in *M&A* activity in India. Specifically, the number of *M&A* in this sector increased from 136 in pre 2000 period to 1218 in post 2000 period (increased from 11% to 15%). The dominance of financial entities in *M&A* activity has been indicated in several studies (for instance, Kumar, 2000; Raju and Deepthi, 2004; Beena, 2008, Satyanarayan and Manju, 2011; Kaur, 2012). In view of the importance of financial sector, the subsequent table (Table 8) reports the *M&A* in this sector during 2001-07.

Table 8. *M&A* in India's Financial Sector (% of total *M&A*), 2001-07

Year	Mergers in Financial Sector (%)	Acquisitions in Financial Sector (%)		Both <i>M&A</i> in Financial Sector (%)
	Number	Number	Value	Number
2001	33.5	9.6	NA	14.3
2002	31.9	11.9	12.9	17.1
2003	27.8	9.6	9.8	14.5
2004	15.6	9.2	7.1	10.6
2005	24.7	14.1	13.4	17.5
2006	14.3	14.5	15	14.4
2007	12.6	14.8	8.7	14.4

Data Source: Author's calculations from *M&A* database, CMIE

Note: The information on mergers was available only in terms of number and not value. However, for acquisitions both number and value involved were available.

Of the total mergers in 2001, almost 34% take place in the financial sector (column 2). The per cent share of mergers drops continuously till the year 2007 (when it is almost 13%), except in the year 2005 when an increase is observed. Thus, the share of financial sector in overall merger activity in India has reduced from 1/3rd in 2001 to almost 1/10th in 2007. However, in acquisitions (both number and value) much less variation has been observed and in no year the share exceeds 15%. More precisely, number of acquisitions has increased from 10% in 2001 to 15% in 2007 (column 3). Further, in terms of value of acquisitions, no discernible trend can be seen (column 4). It may be noticed that in terms of numbers, mergers have outnumbered acquisitions until 2005. On the contrary, after 2005, the number of acquisitions exceeds mergers. Due to this, the number of *M&A* has remained more or less constant over this period.

This suggests that the firms in their restructuring exercise have increasingly shown preference for acquisition compared to merger. This finding has also been revealed in other studies, for instance, Cummins *et al.* (1999), Report of International Labour Office (2001), Agarwal (2006) and Kumar and Rajib (2007). A possible explanation for the preference of acquisition as a restructuring mechanism, apart from the lower financing requirements, could be the fact that procedural lags as well as rules and regulations with regard to acquisitions are relatively less time consuming and easier compared to a merger. Besides, the integration issues or cultural clashes are likely to arise in mergers. Further, given the competition and regulatory concern arising from mergers, the share of acquisitions is likely to continue to be higher than that of mergers in the future as well.

The present section emphasised the importance of India in global M&A activity and the role of financial sector in India's M&A activity. It has been seen that M&A activity in the financial sector has increased significantly in India and other countries. What factors could account for this rising M&A activity in the financial sector? The subsequent sections explore the role of financial sector and the factors resulting in increase in M&A.

4. Role of Financial Sector

The financial sector plays a significant role in smooth allocation of funds for investment. Several developments have resulted in sweeping transformation of this sector. Conventionally, its role was confined to provision of financial intermediation facilities such as inducing, mobilising and allocating savings. More recently, its functions have broadened due to emergence of customised demand for sophisticated financial products based on investor's risk profile (financial derivatives, debt instruments such as structured notes, syndicated loans, coupon strips, bonds etc.). In addition, the financial entities capacity to provide the sophisticated products has improved as a result of both rapid developments in finance and advancements in technology. Hence, the financial sector is expected to provide numerous facilities, apart from mobilising savings and facilitating lending, such as trading, hedging, pooling, risk management, insurance, evaluating projects, monitoring borrowers, disciplining managers and exerting corporate control. Further, it is expected to facilitate exchange in an economy by providing adequate liquidity using technologically developed payment and settlement system. All these functions enable smooth conduct of economic activities, thereby, enhancing economic growth (Stiglitz *et al.*, 1993; Mohan, 2006; Dholakia, 2008; Kohn, 2009; Krugman, 2009; Karunagaran, 2011).

Accordingly, a growing body of studies have established a link between finance and economic growth (King and Levine, 1993; Levine, 1997; Levine *et al.*, 2000; Gomes, 2004; Beck and Levine, 2004; Phillipon, 2008). Particularly, since the prominent contribution by Levine (King and Levine, 1993; Levine, 1997) providing empirical evidence on positive relationship between financial development and economic growth, the literature on finance-growth nexus has been mounting (Thiel, 2001; Blum, *et al.*, 2002; Gomes, 2004). However, these studies provide diverging opinion on the role of financial sector.

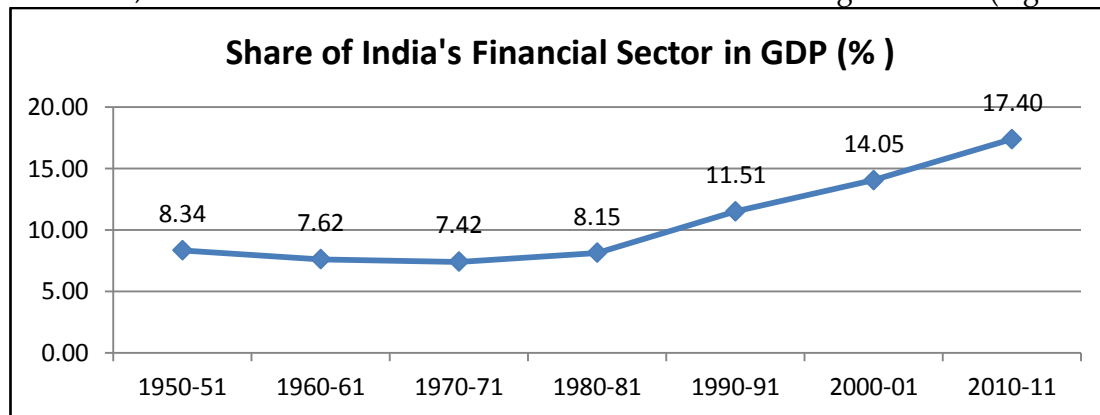
One school of thought believes in little need for financial institutions in an economy. For instance, Arrow (1964) and Debreu (1959) assume little role of financial sector in a perfect economy characterised with zero information and transaction costs (Levine, 1997; Thiel, 2001; Blum *et al.*, 2002; Gomes, 2004). Further, the welfare economics does not extend its analysis to efficiency in financial markets (Stiglitz *et al.*, 1993). These studies provide little significance to the financial sector. Another set of studies have argued that financial development may simply follow economic development (Robinson, 1952; Lucas, 1988).

The recent literature attempts to highlight the importance of financial intermediation in growth by referring to the work of economists such as Adam Smith's, 'Wealth of Nations' (1776). In this context, the financial sector enhances specialization and promotes growth by facilitating

exchange and reducing transaction costs. Smith emphasised that high density of banks in Scotland was an important factor in rapid development of the Scottish economy (Blum *et al.*, 2002). Again, during the beginning of 20th century, the pivotal role of financial sector was highlighted by Schumpeter (1911) in bringing about radical transformation in existing methods of production and creation of new innovative products through the Schumpeterian process of 'Creative Destruction' (Sinha, 2001; Blum *et al.*, 2002; Leathers and Raines, 2002).

The role of finance in an economy has also been highlighted in traditional and endogenous growth theory. The key implication of these models is that capital accumulation and technological innovation constitute an important condition for steady-state growth (Romer, 1994). These models suggest that growth may be positively associated with the ability of the financial sector to induce savings and investment (Blum *et al.*, 2002).

A fundamental indicator of financial development of an economy is the contribution of finance and related activities to GDP. The rising share of finance in GDP in most economies suggests that financial sector is evolving rapidly over time (Phillipon, 2008). This is true for India as well. In India, the share of financial sector in GDP has been increasing over time (Figure 1).



Source: Author's calculations based on GDP_{FC} in Economic Survey, 2010-11

Figure 1: Evolution of Financial Sector in India, 1950-2011

In India, the share of financial sector in GDP stood at 8.34 percent in 1950. The period was characterised by strict autarkic controls and restrictive government policies. Prior to 1980s, the share remained by and large the same, in fact it declined marginally in 1970-71. However, an increasing share of the financial sector has been observed, especially after 1980s. Nevertheless, in comparison to advanced economies the role of financial sector is modest. While, the percentage share of financial sector in GDP in India increased from 8.34% to 14.71 % (i.e. by a factor of 2.08) over the period 1950-2005, in contrast, during the same period, the share in U.S. increased (by a factor of 3.31) from 2.32% and 7.69% (Phillipon, 2008). This indicates that although India's financial sector has developed enormously, it has a long way to go.

As a result of the increasing significance of financial sector in an economy, there is a renewed global interest in finance, predominantly, financial markets, products and entities. It has been long argued that the financial markets are strikingly different from other markets (Stiglitz *et al.*, 1993). While it is growing in significance, it is subject to market failure arising from the existence of imperfections such as information costs and asymmetric information resulting in problems such as moral hazard and agency concerns (Thiel, 2001; Gomes, 2004; Kohn, 2009). Moreover, the pressures of the 'maturity mismatch' between the assets and liabilities make these financial entities, particularly banks, susceptible to crisis. Essentially, a significant proportion of their assets have a long term maturity (i.e. lend long-term illiquid loans such as mortgages) while liabilities are of short term maturity (i.e. borrow short-term deposits payable at short notice). This intrinsic inconsistency in the structure of these entities enables them to create liquidity by means

of pooling to conduct intermediation smoothly in normal times, but, exposes them to interest rate and illiquidity risks in case of 'bank runs' resulting from loss in consumer confidence (Kohn, 2009; Rangarajan, 2009).

In order to reduce the incidence and severity of recurring financial crisis, central banks regulate the financial sector, especially large banks and financial entities in almost all economies. In particular, the central banks in all countries provide a safety-net to rescue or bailout the large financial entities considered 'too big to fail'⁸. Do these safety-nets provide additional incentives for the firms in the financial sector to grow big either organically or inorganically through *M&A*? The growth of a financial entity may be incentivised by these safety-nets. Consequently, these large entities, particularly in the financial sector may wield significant economic and political power thereby influencing the working of the economy such as by restricting the supply of credit to certain borrowers.

5. Factors Explaining Rising *M&A* in the Financial Sector

M&A, particularly in the financial sector, are gaining enormous importance in the recent times due to related forces of deregulation, globalization and financial innovation (Berger, Demsetz and Strahan, 1999; Kohers *et al.*, 2000; Group of Ten Report, 2001; Amel *et al.*, 2004; How *et al.*, 2005; Mohan, 2005). In what follows, the importance of these forces in influencing *M&A* activity is discussed.

Deregulation: The decline of Bretton Woods System in the 1970s resulted in deregulation in financial sector of advanced and emerging economies (Rangarajan, 2009). The experience of advanced economies suggests that deregulation could have triggered consolidation in these countries in 1980s and 1990s. For instance, in USA, dismantling of various banking restrictions such as the Riegle-Neale Inter-state Banking and Branching Efficiency Act of 1994 paved the way for higher number of mergers across geographical boundaries. Similarly, the Glass Stegall Act of 1933 opened possibility of mergers across diversified financial activities (Hagendorff and Keasey, 2009). Traditionally, the financial sector in India was highly controlled, restricting an entity's activities. In 1991, the government pursued a gradualist approach to financial sector reforms. Due to various measures of deregulation in the financial sector, notably, deregulation of interest rates, reduction of statutory requirements (based on liquidity, reserves, credit etc.) and a general reduction in entry barriers for domestic and foreign firms resulted in free market forces and greater competition. Within the banking sector, reforms were composed of establishment of new banks in the private sector, entry of foreign banks, allowing foreign direct investment in private sector banks up to 74 percent, etc. (Rangarajan, 2009).

In the wake of this changing legal and regulatory framework, the competitive pressure on banks and financial entities increased. Further, deregulation has permitted financial entities to diversify both in terms of geographical boundaries and activities such as insurance, securities, foreign exchange, leasing, credit cards, mortgage financing, investment banking etc. (Verghese, 1990; Shirai, 2001; Mohan, 2005; Sen & Ghosh, 2005; Chandrasekhar and Parthapratim, 2006). This has narrowed the profit margins. As a result, financial entities are compelled to seek ways to improve performance and reduce cost. In this sense, deregulation is considered as an important determinant of *M&A* activity amongst financial firms by attracting entry of new firms (Luypaert, 2007).

⁸ The term 'too big to fail' originated in U.S. to indicate the financial entities that have become extremely large and interconnected such that their failure may result in financial crisis. Hence, these are likely to be rescued by government in the time of financial trouble.

Globalisation: Globalisation means integration of different economies through a free movement of goods, services, capital, ideas and people (Streeten, 2001; Bhagwati, 2003; Panagriya, 2004). Since 1991, India has embarked on the path of reduction in barriers to trade (Shah *et al.*, 2009). With globalisation (a result of both technology and deregulation), firms are increasingly entering into consolidation and restructuring activity, particularly, cross border M&A to rapidly gain size and access to global financial markets (Basant and Morris, 2000; Kumar, 2000; Beena, 2001, 2008; Agarwal, 2002; Mohan, 2005; Chary and Pawar, 2011).

While deregulation has resulted in reduction of regulatory constraints on domestic activities of financial entities, globalisation and improvements in technology entails a diversification and spread of financial activities internationally. The pace of consolidation in the financial services sector is likely to accelerate further in the future given the continuous reduction in regulatory barriers (Khandelwal, 2006). This could be because while the non-financial firms expand their geographic coverage (through M&A or otherwise) they expect the financial entities to geographically diversify and consolidate to meet their changing demands (Group of Ten Report, 2001). Though this is likely to result in lower cost of financial products, but, it makes the global economy highly vulnerable to contagion.

Technology: The modern economic growth has been propelled by efficient and wide use of technology and scientific knowledge (Kuznets, 1966). The developments in modern technology have reduced the cost of storing, processing and distributing information for financial entities, thereby, reducing the market imperfections. Moreover, it has enabled financial entities to offer customised financial instruments and better services (such as 24 hours internet banking) over wider geographical areas opening possibilities for exploring global financial markets (Shull and Hanweck, 2001; Group of Ten Report, 2001). In a similar manner, these entities could explore domestic markets by expanding their reach into rural depths of the country, in an attempt to achieve the objective of financial inclusion (Rangarajan, 2009). Accordingly, studies have suggested the rise in M&A activity due to unrestrained change and innovation in the financial markets (Verghese, 1990).

But, at the same time, the new technology might increase fixed costs (such as advertising, ATM, and branch network). This could encourage entities to consolidate in order to spread the high fixed costs over a larger customer base. Further, the sharing of automated teller machines (ATM) as well as pooling back-office administrative operations (such as data processing) would augment the gains from consolidation. However, the benefits of technology should not be exaggerated, as presently, it may not be completely feasible to replace internet banking with branches in India.

To summarize the discussion above, the interconnected forces of deregulation, globalization, financial innovation and technology are all working simultaneously to increase competition among financial entities. This has resulted in blurring the distinction between banks and other financial firms leading to increasing links among capital markets, credit markets, insurance firms, banks and NBFCs (Claessens and Klingebiel, 2001; Karunakaran, 2011). Consequently, there has been a rise in financial supermarkets in the form of universal banks that are able to provide a wide gamut of financial services (Llewellyn, 1999; Khandelwal, 2006). The resulting diversification is likely to promote efficiency in the financial system as banks and financial entities are effectively able to utilise the existing information on customers. For example, when an insurance firm merges with a bank, it is likely to result in lower cost as banks could underwrite securities at a lower cost due to greater awareness on the credit worthiness of borrowers (Shirai, 2001).

6. Conclusion

The analysis attempts to identify trends and patterns of M&A in various sectors in India over time. An attempt to explore the importance of India in global patterns of M&A, specifically in the financial services sector has also been made. In this context, the role of factors such as deregulation, technology and globalisation in determining M&A activity has been highlighted.

It was observed that India has been lagging behind other advanced and emerging economies in terms of both number as well as value of M&A. It has also been seen that there has been notable acceleration in M&A in the post 2000 period, particularly in the financial sector of India. A careful analysis reveals an interesting pattern in the M&A activity. The sectors such as paper products, printing, publishing, media & entertainment, food products, textiles and non-metallic mineral products, metals, machinery, automobiles and miscellaneous manufacturing have shown relatively little involvement in M&A activity.

The differential participation of various sectors in M&A activity may be explained by macroeconomic factors which may affect the entire sector like growth, reform measures, taxation and government policy or micro economic factors intrinsic to a firm such as the efficiency of firms, potential benefits that firms expect to derive from economies of scale or managerial factors. For instance, it has been observed that pharmaceutical, telecom and financial sectors have witnessed the most fundamental reforms since 1991. Accordingly, it would be highly useful to analyse the link between liberalisation measures and involvement in M&A activity in different sectors (Andrade *et al.*, 2001).

The investigation of trends in various sectors presents a backdrop for the possible implications of Indian financial services sector integration. The significant number of M&A in the financial sector opens avenues to explore the motives and benefits that firms achieve while participating in M&A.

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