IIMK/WPS/119/ FIN/2013/05

EARNOUTS A RISK MITIGATING STRATEGY FOR CROSS BORDER ACQUISITIONS IN INDIA

Reena Kohli[1]

An attempt has been made in this study to assess the impact of different modes of payment employed in cross border acquisitions, viz. cash, earnout and stock on the risk profile of the acquiring companies in India. The purpose is to discern which of the stated modes of payment enables an acquiring company in better hedging the risk of adverse selection that arises due to the information asymmetry on the part of the acquiring company regarding the true value of assets of the target company. It has been found that of the three modes of payment, earnouts provide best hedge to the acquiring companies for minimizing the risk of adverse selection in cross border acquisitions. The reason being earnouts enable an acquiring company resolve the problem of over-valuation and that of non-performance by making part payment contingent on the ex post performance of the target company as well as by retaining target company's managers respectively. The paper recommends earnouts as a valuable strategy for the acquiring companies from India as well as other emerging markets for their future global acquisitions as these companies usually end up overpaying the target companies due to lack of expertise in cross border acquisitions. The paper has tried to fill the void in the existing literature by explicitly analyzing the impact of the different modes of payment on the risk profile of acquiring companies in the post acquisition period.

For further details, including copies of working papers, please write to:

Research, Conference & Publications Office,
IIM Kozhikode, IIMK Campus PO, Kozhikode 673 570, Kerala, India

Phone: (91)0495 2809238
Email: rcp@iimk.ac.in

[1] Assistant Professor of Finance at Indian Institute of Management Kozhikode, Phone: 91-495- 2809422, email: *reena@iimk.ac.in*