

# IMPACT OF MERGER ANNOUNCEMENTS ON STOCK RETURNS OF ACQUIRING FIRMS: EVIDENCE FROM INDIA

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**Abstract** *Present study examines the impact of merger events on stock returns of acquiring firms. The sample size is composed of 428 merger events that took place during 2008 to 2015 other than financial sector and agricultural mergers. Event study methodology has been applied by using seventeen days event window i.e. -8 to +8 days stock returns. Results indicate that merger deals do not bring any abnormal changes in stock returns pre and post event date, which implies that traders are not able to gain abnormal returns in pre-post event period. These findings are consistent with Bradley et al., (1988); Servaes, (1991); Mulherin and Boone, (2000), Khan (2011), Kemal (2011), Khanal et al. (2014). The findings obtained from this research may be helpful for researchers, fund managers, market regulators, investment managers etc.*

**Keywords:** *Merger, Acquisition, Stock Return, Event Study Analysis, Average Abnormal Return, Cumulative Average Abnormal Return*

## INTRODUCTION

Previous two decades have observed phenomenal changes/reforms in the size, management philosophy, turnover, product/geographical diversification in global business space. Merger and acquisition (M&A) has been one of the strategic decisions taken by business organizations for coping up with unforeseen threats and capitalizing possible opportunities available in the market. Both developing and developed countries has observed that M&A has emerged as one of the strategic processes of corporate restructuring that has gained substantial importance in modern business era (Ghosh and Dutta, 2016). A rapid growth in numbers of merger and acquisition can be seen in Indian economy after globalization, privatization, deregulation and liberalization adopted by various other economies all over the world (Mallikarjunappa and Nayak, 2013). There are various motives for corporate growth and development through corporate restructuring. These motives can be classified in two categories: Value maximizing motives and Non-Value Maximizing motives. Under value maximizing motives corporate growth, economies of scale and economies of scope can be the motives behind corporate restructuring, while under Non-Value maximizing category the reasons may be increasing job security, manager's appetite for

controlling a larger organization etc. However, technological growth, financial distress in industry, global amalgamation of markets, increased financial alliances and regional restrictions can be the other possible reasons for the M&A's trend (Bashir et al. 2011).

The concept of corporate restructuring and adoption of M&A event as growth strategy by companies induce the researchers, managers and journalists to look into the matter deeply (Kreitl et al., 2002). Besides examining motives for M&A, another reason to evaluate M&A deals is to know the post-merger financial and stock market performance of the related firms. Various studies which focuses on the stock market performance of acquirer firms in the pre and post-merger period have documented different results after the execution of a M&A event. Some studies shows positive while other shows negative impact on post-merger performance of acquirer firms (Rani et al., 2013). This debate is yet unsettled, which is the main driving force for the researchers and analysts to take a deep dig in this topic and find how these events affect firms and share prices during pre and post-merger period. (Andrade et al., 2001; Holmstrom and Kaplan, 2001).

Acquiring firm's performance has been extensively studied empirically to examine the impact of M&As on financial performance and Stock market performance

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(Frank T. Delaney et al., 2004). The present study is an attempt to examine the impact of mergers and acquisitions announcements on the stock returns of acquirer companies from pre-post perspective, in context of India. Discussion in this paper has been organized in six different sections. Section-I contains the introduction to the problem. Section-II reviews a strand of studies investigating the impact of merger and acquisition on shareholder's return. Section-III explains the research objectives and database of the study. Section-IV explains the research methodology. Section-V discusses the results and analysis. Section-VI provides the implications of the findings in this study and concludes the study.

## LITERATURE REVIEW

A strand of literature has examined the effect of M&A activities on post-merger financial and stock price performance of acquiring as well as target firms. The literature on impact of M&A on stock returns can be divided in to two parts i.e. theoretical literature and empirical literature. Both literature provides evidence after examining the financial performance and stock market performance of target firms as well as acquirer firms, but yet no conclusive results can be found regarding the question whether M&A leads to gain to the acquirer company's shareholders?

According to the theoretical literature, numerous studies on the effects of M&As deals on the performance of engaged companies have appeared over the past few decades. These studies have been conducted from the different perspectives such as profitability, market performance, shareholder's value etc. (Omah et al., 2013). Whereas, results obtained from these numerous studies differ from each other. Many questions like whether these deals lead to profits or losses, value creation or value destruction, wealth gains for target or acquirer or combined firm are still unanswered (Rani et al., 2015).

Empirically, the wealth effects of M&As deals are found by researchers by conducting event study methodology (Adnan and Hossain, 2016). Studies conducted by various researchers to analyze the short term wealth effect of M&A have used event study methodology. (Dodd, 1980; Schipper and Thompson, 1983; Asquith, 1983; Pettway and Yamada, 1986; Dennis and McConnell, 1986; Schipper and Smith, 1983; Sicherman and Pettway, 1987).

Jensen and Ruback (1983) found that the bidder's stock has a 4% gain in tender offers and no gain in merger deals. Gaughan (2005) reported that M&A deals effect the wealth of acquirer's shareholders either negatively or wealth effects

are neutral. Hackbarth and Morellee (2008) documented that the mean value of CAR by taking 3 days return is negative for acquiring company's shareholders. Jarrel et al. (1988) analyses 1086 takeovers during 1985-2002, and reports small but statistically significant gains of about 1% to 2% for the bidding company's shareholders. On the contrary, Bradley et al., (1988) reports less than 1% gain to acquirer's shareholders. Whereas the studies like<sup>1</sup>, have reported positive abnormal returns up to 7% to shareholders of acquiring firm, Sinha et al. (2011) was of the opinion that acquirer were able to generate value in long run. On the contrary, some other studies have documented negative returns to the shareholders of acquiring firm. (Corhay and Rad, 2000; Datta and Puia, 1995; DeLong, 2001; Doukas et al., 2002; Goergen and Renneboog, 2004; Houston et al., 2001; Mitchell and Stafford, 2000; Morck et al., 1990; Mulherin and Boone, 2000; Sirower, 1997; Walker, 2000; Srinivasan et al., 2006).

Chatterjee 2011, Kemal 2011, Yen and Andre 2010, Flugt 2009, Hu 2009, Girma 2008 reported that M&As have negative impact on acquiring firm's profits as well as stock prices. Morck et al. (1990) found that acquirer firms have systematically lower and significantly negative return around announcement period of event.

Bris and Cabolis, 2004; Dennis and McConnell, 1986; Andrade et al., 2001; Bradley et al., 1983; Brekovich & Narayanam, 1993 observed mixed results in their studies. They reveals that the acquiring companies do not gain or lose in merger deals and suggest that the stock prices of acquiring firms after a M&As deal may increase or decrease.

Saboo and Gopi, 2009 claimed that performance of bidding firm after a M&A deals depends on the type of deal i.e. whether it is a domestic deal or a cross-border deal. Some studies evidences that domestic merger deals does not create value for the acquirer's shareholders but cross border mergers and acquisition are more beneficial for the acquirer companies (Kohli and Mann, 2011). Franceour, (2005) suggested that acquiring firms engaged in cross border M&As earn efficiency gains and created values for shareholders.

The above mixed results create complexities in concluding whether the stock performance of acquiring firms is favorable or not for the shareholders (Bruner, 2002). The reasons

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<sup>1</sup> (Doukas et al., 2012; Anand and Singh, 2008; Fee and Thomas, 2004; Beitel et al. 2004; Kiyamaz, 2003; Canina, 2001; Eckbo and Thorburn, 2000; Kohlers and Kohlers, 2000; Maqueira et al., 1998; Schwert, 1996; Cakici et al., 1996; Markides and Ittner, 1994; Firth, 1980).

behind these mixed results are various factors affecting the performance or stock return of acquiring firm. Some of the factors empirically found by various researchers are: method of payment, firm size, type of merger and acquisition, asset base of acquiring firm, type of industry, success of deal etc. Some researchers found that the results of different studies are also differs because of different event windows, different sample period, different economy taken in previous studies to examine post M&As returns to shareholders (Ismail et al., 2011; Williams, 2010; Hu, 2009; Mantravadi and Reddy, 2008). Some studies found that post-merger performance results are negative in short run and positive in long run (Adnan and Hossain, 2016; Asquith, 1983; Magenheim & Muller, 1988).

Though M&A is a well-researched area but still many questions regarding gains from these deals are unanswered (Mohanty and Mishra, 2014). The empirical findings obtained in the existing M&A literature are conflicting in nature and the true gains from these events are still indeterminate. Therefore, the current paper makes an attempt to fill this gap and contribute to the existing literature, regarding impact of M&As on acquirer firms performance particularly in India, by empirically testing it with the help of event study methodology.

## RESEARCH OBJECTIVE AND DATA

Based on the research gap found in the literature survey, the objective of present study is to examine the impact of merger announcements on the stock returns of acquirer companies in context to India, during 2008 to 2015. This study makes an attempt to know the real benefit or loss to the acquirer's shareholders in India and to contribute to the literature of mergers and acquisition and acquirer's performance. For conducting the study a sample consisting of 428 companies have been taken and their closing prices have been taken to calculate the abnormal returns for the analysis. The data used in this paper is secondary data, extracted from Ace-Equity database.

The data-filtering process took the following steps:

First, all the mergers that took place during 2008-2015 were identified. Total number of complete merger events that took place during that period were 1108.

Second, this study excludes merger deals that took place in the financial sector because of different accounting procedures followed by financial sector companies.

Third, this study excludes merger deals that took place in the agriculture sector.

Fourth, study includes the companies listed on National Stock Exchange of India (NSE) during the period and excludes those which are not listed at NSE.

Fifth, because of non-availability of required data on NSE and other data limitations, the final number of deals considered for this study were narrowed down to 428 deals. This paper has used the secondary data extracted from Ace-Equity database.

## Benchmark Returns

In order to examine the abnormal returns to the acquiring company's shareholder after an event of merger and acquisition, this study needs to compare the normal returns calculated by author with the some benchmark portfolio returns. This comparison is made to know the estimate of normal returns an acquiring firm would have generated without the happening of any merger and acquisition event. For this reason this study took nifty return data for the same period i.e. from 2008 to 2015, and calculated returns from that data. Than after comparing both the returns abnormal returns are generated.

## METHODOLOGY

In this paper, an event study methodology has been applied to examine the effect of a particular event (Merger) on the dependent variable, which is stock return here. Event study methodology has been widely used to know the stock market reactions during the M&As event. The fundamental idea of using this methodology is that the stock price reveals the discounted value of company's future profits. Theoretically the data analysis by using event study methodology is based on the hypothesis that the stock markets are efficient (Fama, 1976), and any information that comes to the market can be easily reflected in the stock prices (Roll, 1986).

Particularly, the purpose of this study is to examine whether the shareholders of acquiring company are able to gain abnormal returns after a merger deal took place. These findings can be obtained by comparing performance of acquiring company, when no such major event took place with the performance of acquiring company after this major event of merger. A seventeen days event window has been taken to conduct this study. The announcement date is specified as day zero in the event time, and further eight days pre- event and eight days post-event NSE return is considered for calculating the abnormal returns i.e.  $-8 - 0 - +8$  is taken as event window for conducting this study.

Firstly, Closing prices of every firm included in sample size of 428 firms, were taken from NSE separately. Then stock returns were calculated by applying the following formula:

$$SR_{jt} = \frac{(R_{jt} - R_{jt-1})}{R_{jt-1}} \quad \text{Equation 1}$$

Where:  $SR_{jt}$  = Stock return of firm j at time t

$R_{jt}$  = Return of firm j on day t

Further, Nifty returns for the same period which is the period of study were taken and nifty returns were calculated by applying the following formula:

$$NR_{jt} = \frac{R_{jt} - R_{jt-1}}{R_{jt-1}} \quad \text{Equation 2}$$

Where:

$NR_{jt}$  = Nifty return for firm j at time t

$R_{jt}$  = Return for firm j at time t

After that nifty returns were deducted from the stock returns in order to obtain the abnormal returns. Following formula was used for calculation of abnormal returns:

$$AR_{jt} = SR_{jt} - NR_{jt} \quad \text{Equation 3}$$

Where:

$AR_{jt}$  = Abnormal stock return for firm j at time t

$SR_{jt}$  = stocks realized return for firm j and time t,

$NR_{jt}$  = expected return for firm j at time t, in absence of a merger event.

After getting abnormal returns average abnormal return for each day separately were calculated. From those mean values cumulative average abnormal return is calculated. A graph is plotted by taking both the average abnormal returns and cumulative average abnormal returns to know the pattern of returns.

## RESULTS AND DISCUSSIONS

This section will show the results from the analysis of the closing prices data taken from NSE to calculate average abnormal returns and cumulative average abnormal returns available to the shareholders of the acquirer firms, during the time span from -8 day to +8 day after the accomplishment of merger event. Author's calculations and results of analysis obtained from the secondary data are presented with the help of tables and line graphs.

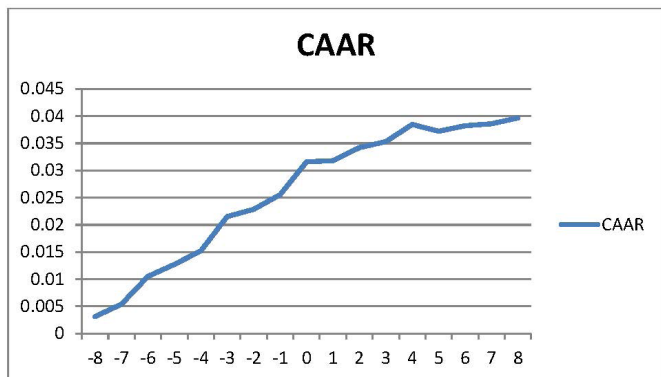
Table 1 provides the mean values of abnormal return of the companies engaged in the event from -8 day to +8 day.

**Table 1: The Results of Pre and Post- Merger Event Average Abnormal Returns (AARs) from Day -8 to Day +8**

Day	AAR	CAAR
-8	0.0031	0.0031
-7	0.0022	0.0053
-6	0.0051	0.0105
-5	0.0022	0.0127
-4	0.0024	0.0152
-3	0.0063	0.0215
-2	0.0013	0.0228
-1	0.0026	0.0255
0	0.0060	0.0315
1	0.0002	0.0317
2	0.0024	0.0342
3	0.0011	0.0353
4	0.0031	0.0384
5	-0.0012	0.0372
6	0.0010	0.0382
7	0.0003	0.0386
8	0.0010	0.0396

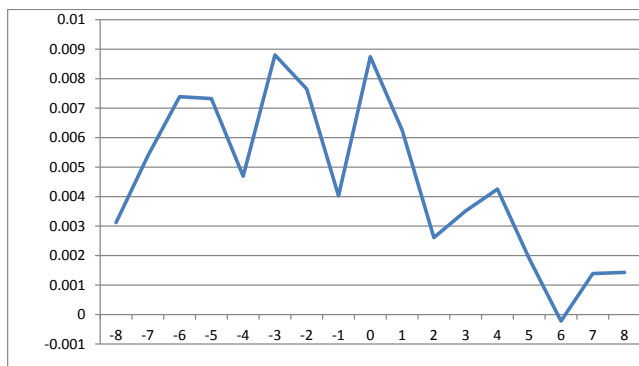
Source: Author's Calculations based on secondary data

From the above table, it can be noticed that the mean value of the abnormal returns to acquirer companies are positive in the pre-event period and remains positive till the announcement date and up to four days after announcement. These findings are consistent with the findings drawn by Kumar et al. (2011), Anand and Singh (2008), Zhu and Malhotra (2008), Gubbi et al. (2010), Barai and Mohanty (2010), Mann & Kohli, (2009), Rani et al. (2010). From the fifth day in the post event period the average abnormal returns begins to decline and become negative. It means information of merger announcement does not bring any sudden hikes and downs or unexpected fluctuations in the share prices of acquirer firms. Chakraborty (2010) mentioned that corporate restructuring deals do not evoke market reaction. These findings are consistent with the findings of Khan (2011), Kemal (2011), Muller & Yurtoglu, (2007) and Shleifer & Vishney, (2003) and are inconsistent with Sharma & Warne (2012). When graph of mean values is plotted, it clearly depicts positive return in pre-event period as well as around the merger event, gradually it starts declining and becomes negative around day 5. (See: Graph 1)



Source: Author’s Calculations based on stock prices data obtained from NSE

**Graph 1: Graphs showing average abnormal return and cumulative average abnormal return during event window from -8 to +8 days**



Source: Author’s Calculations based on stock prices data obtained from NSE

**Graph 2: The Results of Pre- and- Post Event Cumulative Average Abnormal Returns**

## CONCLUSION & IMPLICATIONS

Present study attempts to examine the impact of M&A on stock returns of acquiring firms. Previous research documented evidence that usually the market reacts positively to M&A announcements. To investigate this, a sample of 428 merger events that took place during time period of 2008 to 2015 was extracted from ACE Equity database. The final results are derived with the help of event study methodology and stock returns were calculated from closing prices data obtained from NSE, by taking a seventeen days event window. The study concludes that the shareholders of acquirer firm in India experience positive

abnormal returns before and around merger event, however, gradually abnormal returns decline and become negative in long run.

Findings of the study would be of great use to investment managers, market regulators, global fund managers, companies as well as researchers. The investment managers develop trading strategies to exploit the observable market inefficiencies, and any earning announcement like merger and acquisition can effect or change their trading strategy, so this study helps them to know the pattern of stock return during such events and help them formulate appropriate trading strategy. The market regulator needs to keep a check on their surveillance system to know the existence of insider trading during such information of earning announcements. This study will help the market regulators in this regard. As the sample taken for this study covers a large number of companies and study period is also fairly long, thus the results may be helpful for global fund managers. This is important for researchers to know the perception of investors towards such earning announcements and their behavior can be judge from such informational content. As far as companies are concerned it will be of great help to corporate finance managers to formulate the strategies regarding announcing such an event, keeping in mind the possible market reaction to such announcements and their rival’s strategies. This research will contribute to both the literature on stock return pre- and post-merger event and literature of behavioral finance. This study contributes in existing literature for better understanding of wealth effects of shareholders of acquiring firms. Future research in this area could be extension of the present study by taking longer sample period, by examining impact on target shareholders and by examining impact of these deals in financial sector etc.

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