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Mergers and Stock Market Reaction: Evidence from India

Debi Prasad Satapathy[1], *Sameer Shekhar*[2]

[1] Centurion University of Technology and Management, Odisha, India, [2] Indian Institute of Foreign Trade (IIFT)

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ABSTRACT

The paper tries to search is there any relationship between mergers of acquiringevents and corporate market performance.Mergers and acquisitions have been used by corporate to create value for shareholders through expansion and consolidation. There are extensive studies documented abroad about value creation to shareholders through mergers and acquisitions. The literature on mergers indicates there is a mixed view regarding wealth creation to shareholders both in market-based as well as accounting-based studies. There is a dearth of studies in the Indian context whether mergers create value to shareholders or not. This motivates me to explore whether there is any relationship between creating wealth for shareholders in the short run by using the market-based measure. The objective of this study to explore do acquire firms generate an abnormal return to the shareholders in the Indian context upon merger announcement. The paper tries to examine whether any positive return generated by a firm because of mergers and acquisitions announcedin the short run by using event study methodology. The studyhas takena sample of 371 acquiring for the period from 2008-2013 to analyze the effect of the merger on shareholder wealth by using listed companies in the Indian perspective. The results were found to be a positive abnormal return to the shareholders of the acquiring firm's window period of [-20, 20]forIndian acquiringcompanies.

1. Introduction

This is one most fundamental aspect of the research mergers and acquisitions is one of the important ways ofcorporate control. To encourage corporate expansion by increasing the market share, tax consideration, synergies, and to tap the opportunities of the developed capital market like India through mergers and acquisitions by Indian companies. The decision to go for mergers and acquisitions has a deep impact on both shareholders, managers, customers, and the economy as a whole. It has a lot of short-term and long-term implications on the balance sheet of the acquiring firm. There isa vast literature on the methods and performance of mergers and acquisitions. A lot of studies have happened across the world from the perspective of mergers and acquisitions in Europe, America, and Canada. In recent years research has given attention to focus the corporate control activity in an emerging market like India and China. We have witnessed significant growth in mergers and acquisitions in India, covering many firms in different sectors across the economy. The mergers and acquisitions not only happen in the domestic market but also raise a significant mergers and acquisitions activity in the cross-border segment. This depicts the depth of mergers and acquisition activity and the scope, opportunity, and future possibilities in this area. Domestic merger activity rising largely on the following deals, for example, Sun pharma acquiring Ranbaxy, Kotak Mahindra with ING Vysya, Flipkart with Myntra, and few other sectors too. The Indian economy is the leading economy in the world. The impact ofthe rising trend in mergers and acquisitions activity because of a stable government, policy reforms, well-regulated environment. Given the importance of mergers and acquisitions The study tries to investigate the market performance of the acquiring firms in the Indian context.

2. Literature Review

The evidence on the wealth effects of acquiring a firm provides mixed results. In line with the findings of the study reported zero or positive shareholder return in the US market. The author who have reported zero or positive abnormal return to shareholders in short-run around the announcement period in the US market such as Lang et al. (1991), Moeller et al. (2004, 2005), Faccio et al. (2006), Masulis et al. (2007), Asquith (1983), Schwert (2000),etc. Many studies reported a negative abnormal return to shareholders in the short run around the announcement period in the US market, Franks et al. (1991), Healy et al(1992), etc.In the opposite view, the scholars also studied the impact of mergers and acquisitions on corporate performance in other developed markets like Canada, Japan, Europe. The scholars reported positive abnormal returns in several developed marketssuch as Canada (Eckbo, 1986). Several European countries (Goergen and Renneboog, 2004; Martynova and Renneboog, 2008; Faccio et al., 2006), etc.A few studies have been conducted in the Indian context to judge the market reaction on mergers and acquisitions' impact oncorporate performance by using the market-based measure methodology. Indian studies mostly used accounting-based measures to capture the performance of acquiring companies. The scholars alsostudied returns in the short-run period such asKumar &Panneerselvam 2009, Rani N.,Yadav,S.S., & Jain,P.K. 2013, etc in the Indian context.

3. Research Objective Of The Study

1. To evaluate the impact of mergers and acquisitions announcement on stock price return in the short run of acquiring company in the Indian context
2. To test the statistical significance returnsby using parametric and non-Parametric tests for the different window periods.

Data and methodology of the study

The sample used for this study is collected from CMIE Prowess. The sample was taken of the announcements of mergers and acquisitions bythe listed Indian company. The study period has taken during 2008-2013.The final sample consists of domestic mergers of 771Indian companies. The sample consists of those companies that fulfilled certain conditions that have been included in the study. The stock exchange announcement of the merger has been taken as an event date.To conduct an event study daily adjusted closing price of data, Bombay stock exchange index data has been gathered from prowess database. The daily stock returns have been calculated by taking the log-returns as follows:

$r_{i,T}=ln\,(1+R_{i,t})=\ln(P_{i,T})-In\,(P_{i,T-1})$ ….1

An event study is an established methodology impact of a certain event on the price of a certain type of asset. Abnormal returnsare an important factor to analyzethe impact of events like mergers and acquisition announcements.The idea behind this measure is to separate the effect of other general market movements. The abnormal return is calculated by taking the difference between the actual return and the expected return.The abnormal returns are the difference between the actual returns and estimated returns using a market model

$AR_{i,t}=R_{i,t}-E_{\lfloor R_{i,t}\rfloor}$ … .. 2

$E_{\lfloor R_{i,t}\rfloor}=\hat{\alpha}+\widehat{\beta}*R_{m,t}$ … .. 3

Where is the Abnormal return, is the return of the securities, is the expected return of the securities. and coefficient obtained by using OLS over pre-event window period (-120,-21). .Cumulative abnormal returns (CAR) across the time:

$CAR_i(T_{1,}T_2)=\sum_{t=T1}^{T2}AR$ … .. 4

Then Statistical tests of abnormal returns are commonly based on the cross average of each measure. For cumulative abnormal returns the cross-sectional average is:

$$CAAR(T_{1,}T_2) = \frac{1}{N}\sum_{I=1}^{N} CAR\ \ i\ (T_1, T_{2\,)} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad 5$$

The estimated methodology choice of CAAR is a determinant for the relevance of the results provided in the regression model. The market model is the standard for evaluating the returns around the announcement period (Brown and Warner 1985). The analysis of abnormal return over several event windows captures the information in the context of market reactionbefore the event date,at the event date, and post-announcement period.

4. Empirical Results

Table 1 *CAAR for the CAAR for the whole sample*

Event Window	CAAR	t-Statistics	p-Value	Corrado rank	p-Value
[-20,-5]	-0.0003	-0.0262	0.9791	0.1531	0.8783
[-5,-1]	0.0111	2.3676	0.0179*	1.9961	0.0459*
[0,0]	0.005	2.2875	0.0222*	2.3732	0.0176*
[-10,10]	-0.0046	-0.4322	0.6656	-0.6575	0.5108
[2,10]	-0.0193	-3.0862	0.002*	-3.0997	0.0019*
[5,20]	-0.0071	-0.8457	0.3977	-0.0102	0.9918
[-20,20]	-0.0041	-0.254	0.7995	-0.044	0.9649

*Significant at the 0.05 level
Source: own calculation

Table 1 shows the CAAR for the whole sample, the acquiring company for the event window [-20, 20] is negative and insignificant, before the offer that is pre-event window period [-20,-5], the result indicates negative and insignificant that is (CAAR=0.03%); it seems that shareholder is not able to predict the event or the market anticipation is not there.On the event day itself result indicates there is (CAAR=.05%) and significant, few trading days before the event day [-5,-1], the (CAAR=1.11%) and significant and shows the market reacted to the announcement of the pre-bid merger. For the window period around the announcement that is [-10, 10] the (CAAR= -0.46%) and not statistically significant. At the post-announcement period, few trading days after the event that is [2, 10] the (CAAR=-1.93%) and statistically significant, for the window few more trading days after the event [5, 20] the (CAAR =-0.0071) indicate there is negative return and there is downward pressure caused by short-selling undertaken by the arbitrager. On average, an investor holding an acquirer share for the period for the window of [-20, 20] would earn a return of -0.41%.The event study shows that the short-term acquirer gains are positive and significant on the event date itself, however,there is a negative return to the shareholder in a post-announcement period of acquisitions.

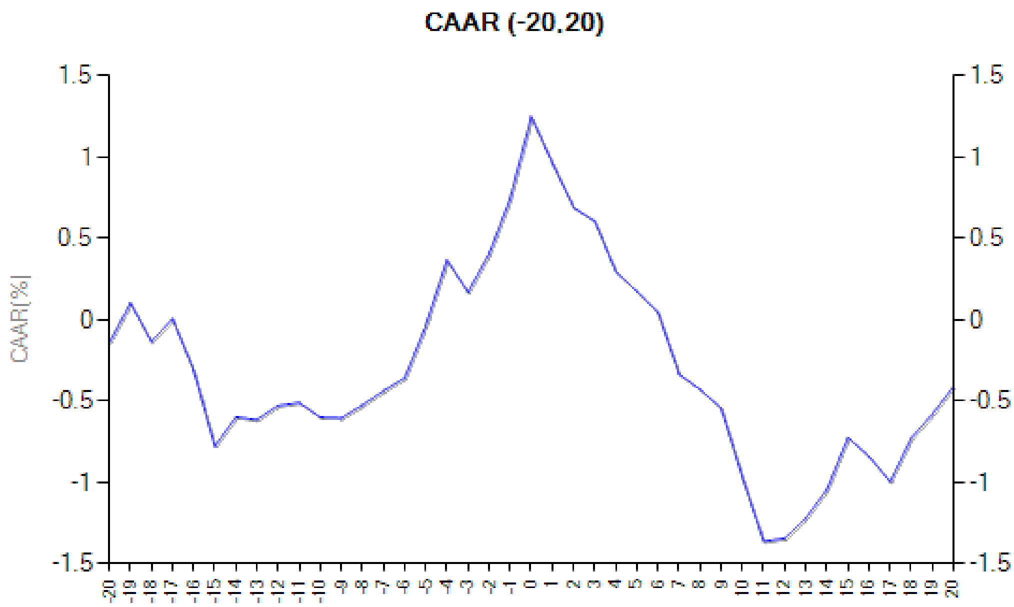

Figure 1 *Cumulative average abnormal returns for the acquiring firms on the window [-20, 20]:*

Figure 1 indicates the CAAR of 40 days window period, on the event day announcement there is positive CAAR, whereas pre-event period there is negative CAAR and the post-announcement merger also figure depicts the substantial negative return to the acquiring shareholder,hence, the shareholder wealth is not created in the overall [-20,20] window period.

5. Conclusion

The paper analyses the short-run market performance of an Indian acquiring company by using different window periods. The sample consists of 371 acquirercompanies during the period from 2008 to 2013 upon merger announcement impact on shareholder wealth during the different window period. The result indicates there is a positive abnormal return in the event date itself. The acquiring company experience a positivecumulative abnormal return and statistically significant in the pre-event window period. However, there is a loss of wealth to the shareholder in the post-event-window period. The findings suggest that the Indian acquiring companies destroy value to the shareholder wealth in a post-event short-run window period. The paper is limited to judge the short-run market performance only for acquiring companies. The sample consistsonly of acquiring companies, however, the study could be made for larger samples as well as the long-run performance of acquiring companies by using the accounting-based measure and long-term market-based measure.

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