IMPACT OF M&A ANNOUNCEMENT AND INVESTMENT FINANCING ON STOCK RETURNS: AN EMPIRICAL STUDY

Abstract Submitted to University of Delhi for the Award of the Degree of

DOCTOR OF PHILOSOPHY

By

RICHA KUMAR

DEPARTMENT OF FINANCIAL STUDIES
UNIVERSITY OF DELHI, SOUTH CAMPUS
NEW DELHI-110021

SEPTEMBER 2013
ABSTRACT

The primary objective of this thesis is to examine the impact of M&A announcement on stock returns and other stock characteristics such as volatility and liquidity. It also attempts to examine whether mode of investment financing has any bearing on the post-event stock returns. In order to achieve the research objectives, an empirical study was carried out to test twelve hypotheses that were articulated. This study uses standard event study methodology for examination of abnormal returns and other stock characteristics of 65 acquirer companies and 37 target companies that were involved in M&A activities during the period 2000-2012, in India.

The results of this study offer very useful conclusions about the market reaction to M&A announcement for acquirer companies in India. On ex-post basis, individual analysis suggests that there is significant impact of M&A announcement on stock returns for almost half of the sample acquirer companies. The results relating to the direction of price reaction are, however, mixed as positive abnormal returns occur as often as negative abnormal returns on post-event basis. These findings are consistent with the finding of a number of studies regarding M&As in India (Sehgal, Banerjee & Deisting, 2012; Kumar & Panneerselvam 2009; Sehgal, Singh & Choudhary, 2005) and M&As abroad (Mitchell & Lehn 1990; Smith & Kim 1994; Walker 2000).

Observing the pattern of post-event CAARs for different short-term event windows, significantly positive CAAR of almost 1.01% (t-statistics=2.00567) is reported over the first 11 days (including the event day). This is in contrast with CAAR during later half of the post event period (-11,-20 day) which was -1.58% (t-statistic= -3.50658). Thus, investors seem to be optimistic in the first phase of post event period, which is followed by correction in the second phase resulting in negative returns. From the perspective of investment analyst, the best portfolio formation window seems to be (-4,0 day), promising a cumulative return of about 2.85% for the 5 day period.

As regards the impact on wealth of shareholders of target companies, there is significant impact of M&A announcement on stock returns for more than two-third of the sample target companies in the sample. The results relating to direction of price reaction are, however, mixed. On aggregate basis, CAARj is positive and statistically significant. It stood at +1.55% (t-statistic = 2.60824) for the twenty-one-days period. This may imply
that target companies have stronger bargaining position than the acquirer companies, tilting the terms of M&A deal in favour of target companies. These findings are consistent with the finding of a number of studies regarding M&As in India as well as M&As abroad. On careful examination of CAARs over different short-term windows, interesting patterns are observed. CAAR is significant and positive for the first phase if 11 days (0,10 day) in the post event period, while it turns negative and statistically significant in the remaining 10 days (+11,+20 day) of the post event period. From the perspective of investment analyst, target company’s stocks provide more profitable trading strategies vis-à-vis the acquirer company’s stocks. The CAAR for the 10 day window (-6,+3 day) is about 9%. These results can help investment analysts in developing profitable trading strategies.

The study also offers a clinching evidence for existence of significant abnormal returns even before the M&A announcement for both the acquirer companies and the target companies. The existence of statistically significant CAR in many cases during the pre-announcement period points toward possibility of leakages of M&A information which may be exploited by the market traders on pre event basis. The study documents that the direction of pre-announcement CAR does provide some clues regarding the direction of CAR in the post announcement for both the acquirer companies and the target companies. An analysis the stock return volatility and trading liquidity indicates that there is no significant difference in these stock characteristics, on comparing pre and post event windows, for both the acquirer and the target companies.

The analysis suggests that the impact of M&A announcement on the stock return of the acquirer’s shareholders is influenced by the mode of investment financing used by the acquirer company. The price reaction seems to be much stronger for non-cash based transactions. This finding on individual basis is consistent with the earlier findings in developed market economies (Andrade et el., 2001). The finding is also consistent with the earlier findings relating to emerging markets. (Sehgal, Banerjee & Deisting, 2012). However, on aggregate basis, there are no clear patterns.

The study has a number of implications for various stakeholders in M&A transactions. For the shareholders of the acquirer company, the study documents significant abnormal returns in the post-announcement window. The study also documents significant relationship between the pre and post-announcement abnormal returns for
acquirer companies. The price reaction seems to be much stronger for non-cash based transactions.

The shareholders of target companies may also get a number of clues from the findings of this study. Both, the individual analysis and the aggregate analysis suggest significant and positive abnormal returns for the shareholders of target companies. This may imply that target companies have stronger bargaining position than the acquirer companies, and as a shareholder of a company which is likely to be the target for acquisition, one can reasonably expect abnormal returns.

The present study has a number of implications for an investment analyst, who might be looking for abnormal returns based on superior analysis. The study suggests that semi-strong form of efficiency is defied for Indian equity market in the case M&A information for the both the acquirer companies and the target companies. Thus, the investment analyst cannot ignore the information regarding the M&A deals. The study also suggests that investment analysts can closely examine the pre-announcement abnormal returns to get some clues regarding the direction of abnormal returns. These finding can help in designing trading strategies.

The existence of significant abnormal returns during pre-announcement period for majority of the sample acquirer companies and target companies points towards the possible leakage of information, much before the public announcement of M&A. This should be a matter of concern for the market regulator like SEBI and attempts should be made to plug such leakage. The defiance of semi-strong efficiency in Indian capital market should also points towards the need for improving the efficiency of the market.

On a number of counts, the present study makes significant contributions to the understanding of the impact of the M&A announcement on stock return and other stock characteristics. This is perhaps one of the very few studies in India which examine the both the market reaction to M&A announcement for both the acquirer and target companies. Inclusion of other stock characteristics like stock volatility and trading volume liquidity in its scope also makes the study unique. The study also examines the relationship between the abnormal returns during the pre-announcement period and post announcement period also sets this study apart from other studies in India. The study offers evidence in support of the influence of mode of financing on stock returns around the date of announcement of M&A deals.