ISSN (Online) : 2455 - 3662
SJIF Impact Factor :3.395 (Morocco)

EPRA International Journal of Multidisciplinary Research

Volume: 2 Issue: 3 March 2016

Published By :
EPRA Journals

EPRA International Journal of Multidisciplinary Research (IJMR) ISSN (Online): 2455-3662
SJIF Impact Factor: 3.395 (Morocco) Volume: 2 Issue: 3 March 2016

IMPACT OF MERGERS ON SHAREHOLDERS' VALUE WITH SPECIAL REFERENCE TO 2013 AND 2014 PROMINENT MERGERS IN INDIA

Mr. Ankesh Mundra[1]
[1]Ph.D. Research Scholar
Prestige Institute of Management and Research,
Indore, Madhya Pradesh, India

Dr. D. T. Manwani[2]
[2] Ph.D. Guide
Devi Ahilya Vishvavidyalaya,
Indore, Madhya Pradesh, India

ABSTRACT

Mergers are growing with the rapid pace in recent time. Shareholders are directly affected by mergers as well. This paper studies the impact of most prominent mergers that happened during the year 2013 and 2014 in India on the shareholders' value. Event study methodology is used in this study and it was found that overall the mergers do create value for the acquirers over a long term period of 365 trading days.

KEYWORDS: *Mergers, Shareholders, Investments, Inputs, Company*

INTRODUCTION

M&A is a general term used to refer to the consolidation of companies. Specifically, an acquisition is the purchase of one company by another, and a merger is when companies combine to form a new company. There are following types of mergers:

- Vertical Merger: A merger is vertical where backward/forward integration is possible. In case one or more companies are the suppliers of some of the basic inputs for the final product to be manufactured by a company, than the latter company mergers with the former company or companies so that it is assured of supplies and is able to control the quality of production of the supplies and also effect economies and improve the profitability of the final product.
- Horizontal Merger: A merger is said to be horizontal if it involves the merger of two or more companies which are producing or rendering the same product or services or product and/or services which competes directly with each other.
- Conglomerate merger entails one entity merging with another entity that manufactures or sells unrelated goods. This could be a boat manufacturer that buys out a camera company.

The mergers deals can be structured in one of the following ways:

- **All Cash**: In such term, the acquiring company pays to the shareholders of target company in cash.
- **All Stock**: In this case, the acquiring company gives its shares in appropriate proportion to the target company.
- **Mixed terms**: In mixed terms, the acquiring company compensates the target shareholders in combination of the above two terms.

RATIONALE AND OBJECTIVE

For a firm characterised by the objective of stockholder wealth maximisation, the appropriate test of the success of a merger is its effect on stock prices. The questions concerning the impact of a merger on the market value of merging firms have occupied a prominent position in the literature of economics and finance for the last half-century in the western context. In response to these questions, a number of carefully conducted empirical investigations have documented the effect of a merger on the wealth of the common stockholders of merging firms. (Rajeshkumar, B. & Panneerselvam, S., 2009).

The objective of this research is to study the immediate, short-term and long-term impact of recent prominent mergers within India on shareholders' value.

LITERATURE REVIEW

The share prices of firms reflect the available information instantly in an efficient capital market (Fama, 1970). Halpern (1973) shows that share prices begin to predict a merger eight months before the announcement.

The literature on the financial effects of mergers and acquisition has drawn on two principal sources of statistical evidence: stock market returns and accounting rates of return (Chatterjee and Meeks, 1996). Acquisitions sometimes yield positive returns for acquirers (Lubatkin, 1987), but generally acquisitions have been found to have a neutral to negative effect on the shareholder wealth of acquiring firms (Bradley, Desai, and Kim, 1988; Jarrell, Brickley, and Netter, 1988).

METHODOLOGY

This study is totally based on secondary data of mergers transactions and the stock prices. The five prominent mergers that happened during 2013 and 2014 in India are considered for the study.

This research uses quantitative techniques. Research used semi-experimental (field experimental) design techniques and referred to standard concepts from event study, market model, regression analysis, abnormal returns and t-test.

The stock returns of the acquirer firms were regressed with benchmark returns which was S&P CNX Nifty (Nifty) in the study for 100 and 150 days to obtain the regression coefficients which were then used to estimate the returns of acquirer firm post merger. Dodd (1980) has used different estimation periods ranging from 100 to 300 for estimating coefficients and found indifferent results. This result prompted an attempt to study whether the estimation period affects the results of event analysis and two estimation windows were considered in the study. Therefore, estimation windows of 100 and 150 days prior to event day are taken for this study.

The market model used for the analysis is as follows:

$$R_t = \alpha + \beta R_{mt} + \varepsilon$$

Where R_{mt} is the return on Nifty for a given day, α and β are the regression coefficients and ε is the error term.

The daily abnormal return is calculated by

AR = Actual Return – Estimated Return

Cumulative abnormal return (CAR) are calculated by adding abnormal returns for the given time period

Average abnormal returns (AAR) are the average of the abnormal returns of all the five companies on a given day

Cumulative average abnormal returns (CAAR) are the total of AARs during the give time period.

RESULTS AND DISCUSSION

1. Merger of Tata Metaliks with Tata Steel:-

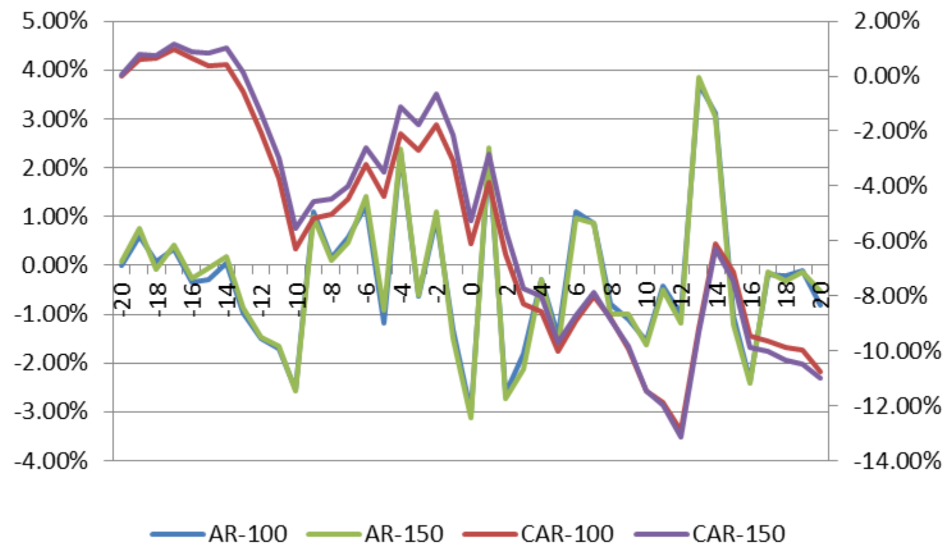
Merger of Tata Metaliks with Tata Steel is a backward vertical integration announced on April 11, 2013. Tata Steel is acquiring 100% stake in Tata Metaliks in an all stock transaction. Terms being such that the shares held by Tata Steel in Tata Metaliks would get extinguished and the public shareholders of Tata Metaliks would get four equity shares of Rs. 10 each of Tata Steel for every 29 shares of (Rs 10-each) TML. (source: http://www.thehindubusinessline.com)

The rationale behind the merger is to create synergies through aligning the activities of a single value chain within one legal entity.

The shareholders of Tata Steel have taken this merger as a value creative over long time period of 365 trading days ended on September 30, 2014. Following graphs details the impacts of this deal announcement on the value of shareholders of Tata Steel

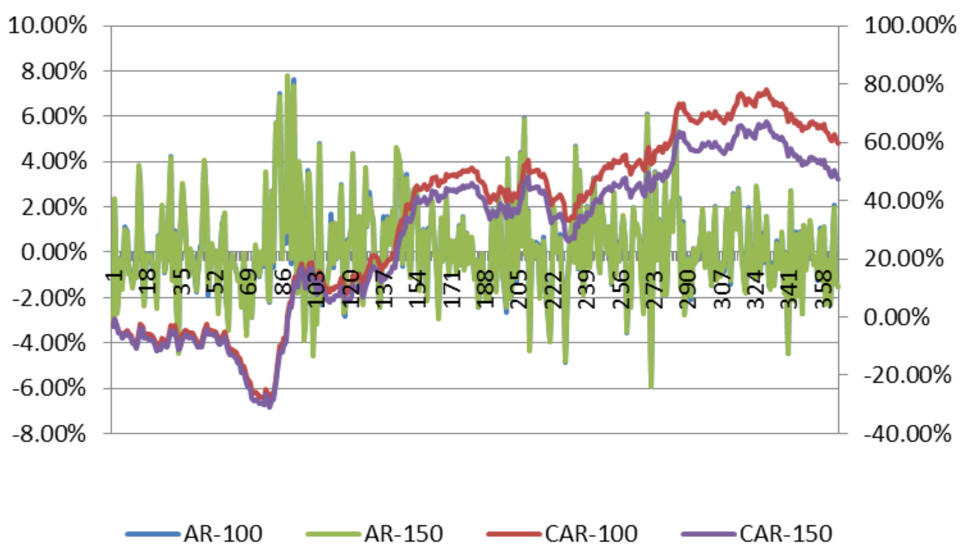
The immediate impact of this deal announcement was negative as the shareholders' value was destroyed by approximately 3% as evident from all the following charts.

Short-Term Impact (-20, 20)



The shareholders' value was destroyed by more than 10% over the short-term (-20, 20) period.

Long-Term Impact (0, 365)



The above charts are evident that the shareholders' value was actually created during the long term period of 365 trading days or one and a half years. The CARs were above 40% and above 60% when calculated on the basis of 150 days and 100 days estimation period respectively.

2. Sterling Holidays merger with Thomas Cook (India) Limited:-

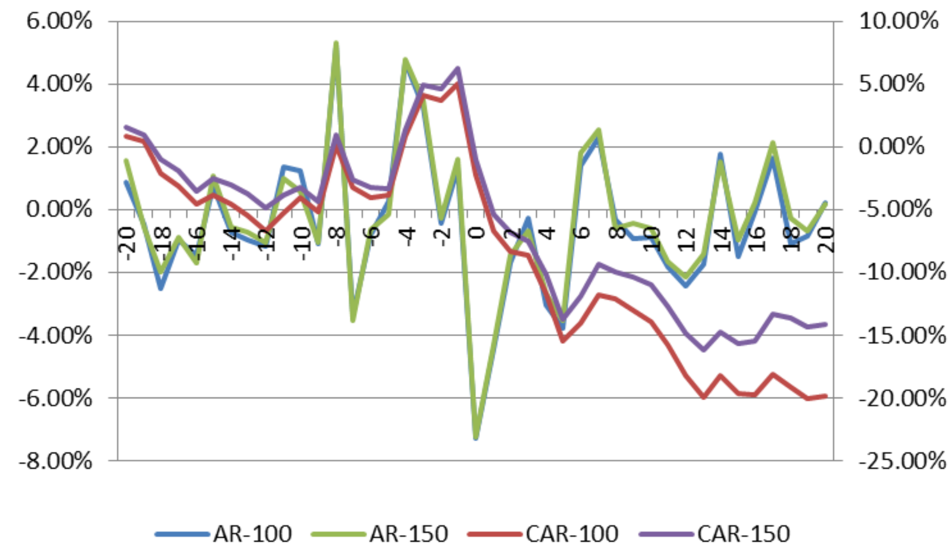
Sterling Holidays merger with Thomas Cook (India) Limited can be considered as a forward vertical merger due to the fact that Thomas Cook being a Tourism sector company will gain access to the network of Sterling Hotels spread across PAN India. The merger was announced on February 08, 2014.

The merger is structured as (Source: http://www.thomascook.in)

- TCIL Group will make a Preferential Allotment Investment for approximately of Rs. 187 Cr.
- into Sterling.
- TCIL Group will purchase shares from Sterling shareholders for Rs. 176 Cr.
- TCIL Group will make a mandatory open offer for Rs. 230 Cr.
- There will be a merger between the two companies at a defined swap ratio of 120:100.

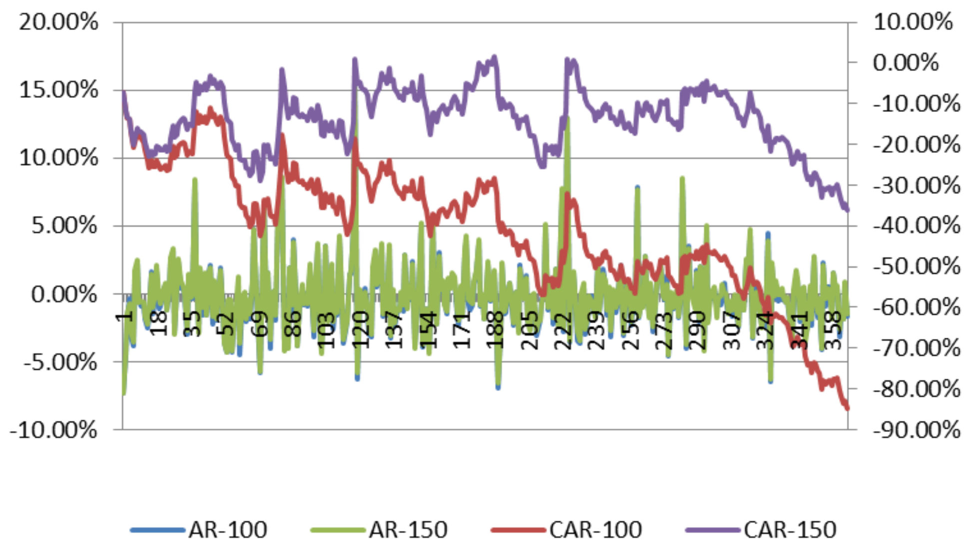
The shareholders' value of TCIL was destroyed by more than 7% on the date of announcement.

Short-Term Impact (-20, 20)



The 41 (-20, 20) days CAARs were -19.82% and -14.14% for 100 days and 150 days estimation windows respectively.

Long-Term Impact (0, 365)



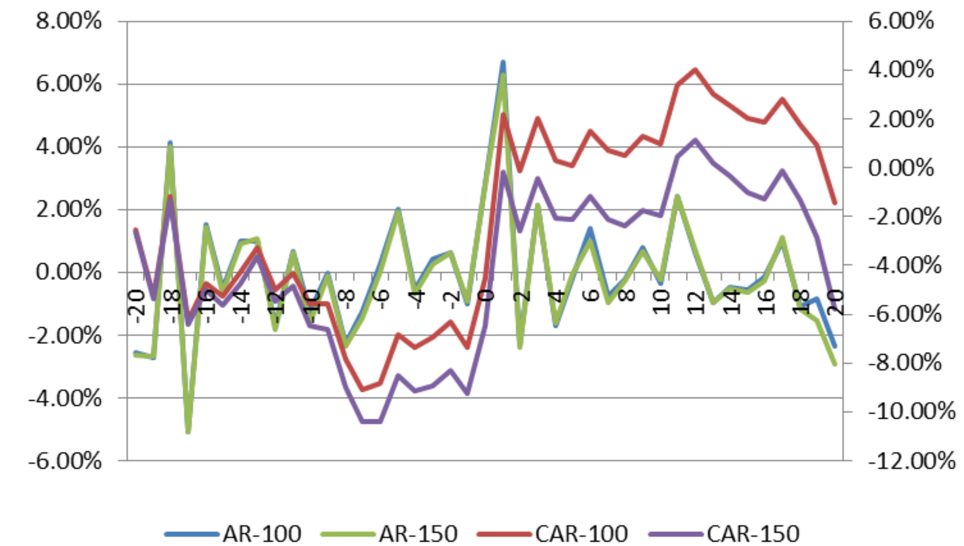
As evident from the above charts that this merger has drastically destroyed the value of shareholders of TCIL. The long-term (0, 365) CARs were below -80% and below -30% when calculated on the basis of 100 days and 150 days estimation period respectively.

3.Sun Pharmaceuticals Industries acquisition of Ranbaxy Laboratories Limited:-

Acquisition of Ranbaxy by Sun Pharmaceuticals made Sun Pharmaceuticals the world's 5th largest specialty generic pharmaceuticals company and India's top pharmaceuticals company. The merger was a horizontal merger announced on April 06, 2014.

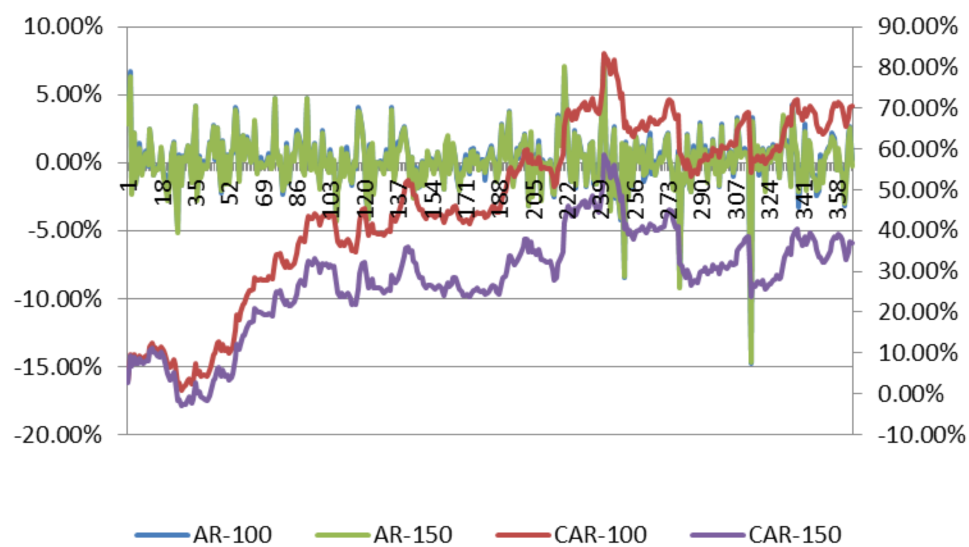
The $4 billion merger was an all stock transaction with terms of 0.8 shares of Sun Pharmaceuticals being issued in lieu of each Ranbaxy shares

Short-TermImpact



The short-term (-20, 20) impact of merger on shareholders' value was destructive as the CARs were -1.42% and -5.77% for 100 days and 150 days estimation periods respectively.

Long-Term Impact



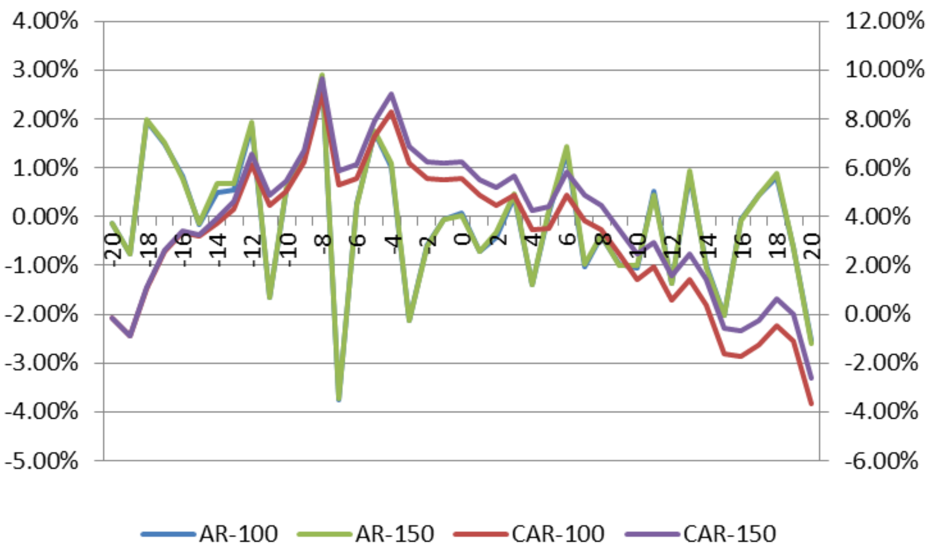
The merger has created value for the shareholders of the acquiring company over immediate term (day 0) and long-term (0, 365). The CARs over these periods were approximately 3% and 70% respectively when calculated considering estimation period of 100 days.

4. Reliance Industries Limited acquisition of Network18 Media & Investments Limited:-

A conglomerate merger happened when India's largest company Reliance Industries Limited (RIL) announced the acquisition of one of the India's biggest media companies Network18 Media & Investments Limited for INR 4000 Crores.

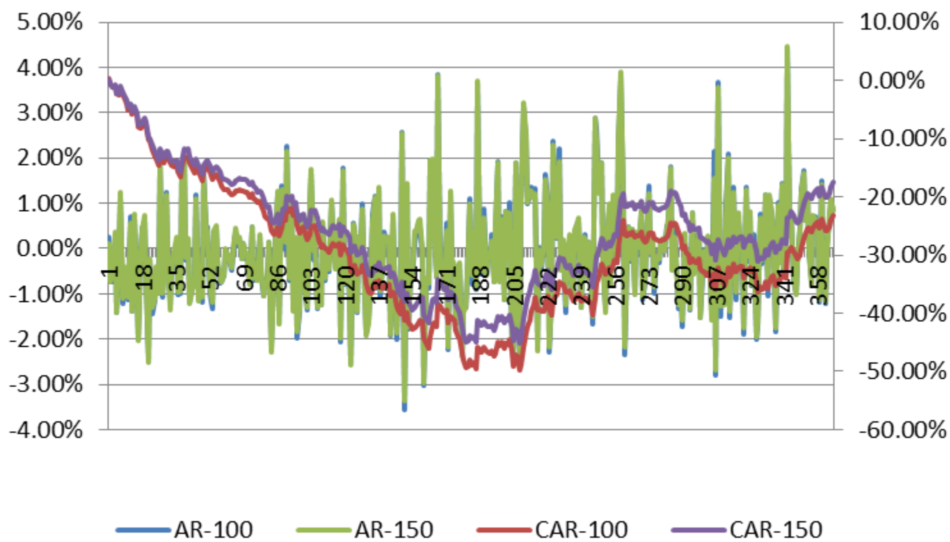
However, the merger resulted in the resignation of CEO, COO and CFO of the target company, its share price closed above 7% on the same day (Source: timesofindia.indiatimes.com). The immediate impact of this merger on the value of Reliance Industries shareholders was found negligible on announcement day.

Short-Term Impact



The short-term (-20, 20) impact of this merger was a value destruction of more than 2% for the Reliance Industries shareholders.

Long-Term Impact



The value of Reliance shareholders was destroyed by more than 15% over the long-term period of 365 trading days or approximately one and a half years.

5. Kotak Mahindra Bank acquisition of ING Vysya Bank:-

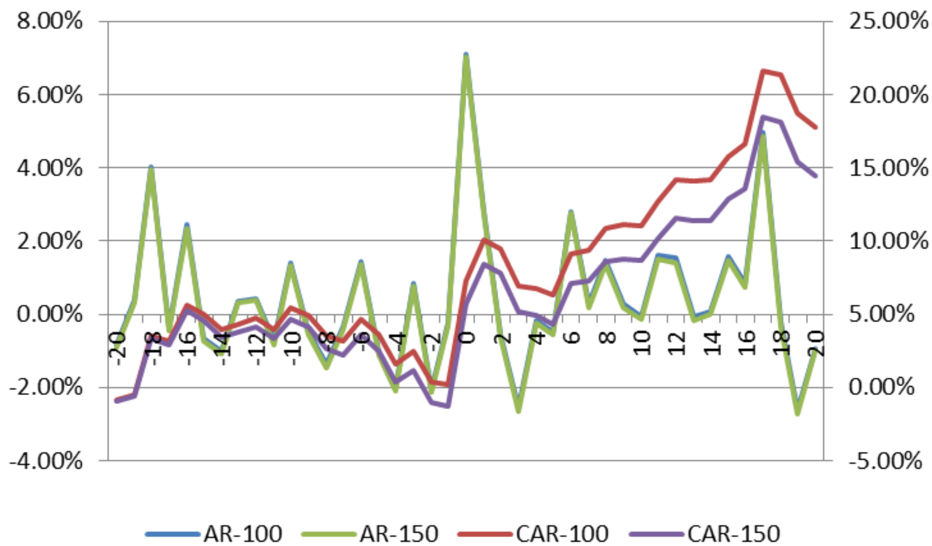
Kotak Mahindra Bank takeover of ING Vysya Bank was the biggest deal in Indian banking sector. This merger was a horizontal merger as both the corporate work in the same area in banking industry. The merger was announced on November 20, 2014.

The deal was structured as an all stock deal where each 1000 shares of ING Vysya Bank will be replaced by 725 shares of Kotak Mahindra Bank.

According to profit.ndtv.com, the deal announcement turned out to be the value creative for both the banks' shareholders as the banks hit record high on merger deal. Whole banking sector took this deal as a positive note and many banking stock gained on this deal.

The immediate impact on day 0 can also be witnessed from this study as the shareholders of Kotak Mahindra Bank gained value of more than 7%. Following are the results:

Short-Term Impact



In a 41 (-20, 20) day period this deal has created a value of over 15% for the shareholders of Kotak Mahindra Bank.

This deal is not too old to conduct the long-term (0, 365) study.

CONSOLIDATED RESULTS

The following table summarizes the overall impact of mergers on the value of shareholders of the acquiring firm.

	100 Days			150 Days		
	CAAR	t	p	CAAR	t	p
(-20, 20)	-3.58%	-6.95	0.0022	-3.82%	-6.43	0.0030
(0, 365)	5.59%	8.94	0.0030	7.70%	13.63	0.0009

It is evident from the above table that the mergers have significant impact on the shareholders' value for 99% confidence level as the p value is all the cases is less than 0.01.

CONCLUSION

It can be safely concluded from this study that the prominent mergers that happened in the year 2013 and 2014 do have a significant impact on acquirers' shareholders' value over both short-term (-20, 20) and long-term (0, 365) period. Also, the results obtained from 100 days estimation and 150 days estimation windows yielded the similar outcomes.

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