

# Industry Effects of Cross-border M&As: Evidence from Short-run Market Reaction of the Indian Acquirers

**P. K Ranju**

Research Scholar  
Department of Business Administration  
Mangalore University  
Mangalagangothri, Karnataka

**Dr. T. Mallikarjunappa**

Professor  
Department of Business Administration  
Mangalore University  
Mangalagangothri, Karnataka

## Abstract

In this study we investigate the impact of cross-border M&As (CB M&As) on acquirers from different industries in India. Using event study methodology, we assess the effects of CB M&A announcements on acquirers belonging to different industries. The results show that acquirers in the healthcare and high technology industries gain significantly from the announcement of CB M&As. Acquirers from the healthcare and high technology industries experience positive and significant CIAARs (cumulative industry average abnormal returns) of 4.17% and 4.46% respectively during the 11-day event window. On the other hand acquirers in all other industries experience insignificantly negative or positive CIAARs. Overall findings of this study show that the wealth effects of CB M&As for acquirers differ depending on the industry to which they belong to.

**Keywords:** Acquirers, CB M&As, Event Study Methodology, Industry effects, India

**JEL Classification:** G34, G14

## Introduction

Globalisation has made the business highly competitive both domestically and internationally. In this highly competitive environment companies have started to venture abroad in pursuit of growth. There are different strategies, like greenfield investments, mergers and acquisitions (M&As), joint venture and strategic alliance, that companies can employ to enter the foreign market. Cross-border M&As (CB M&As) are considered as an important entry strategy for foreign direct investment. What drive the companies to involve in CB M&As are same as in the case of other foreign direct investment decisions. To strategically enhance firm's competitive advantages, to better exploit the a firm's asset, to diversify the risk and quick entry into the foreign market are the factors which drives companies to engage in CB M&As (Li, Li and Wang, 2016). There has been a heated debate on whether the announcement of CB M&As create wealth for the shareholders of acquiring companies or not. Present literature on this issue has provided conflicting results. Studies by Mentz and Schiereck (2008), Gubbi et al. (2010), Bhagat, Malhotra and Zhu (2011), Nicholson and Salaber (2013), Edmura et al. (2014), Gregory and O'Donohoe (2014); Rani, Yadav and Jain (2015a, b), Zhu, Xia and Makini (2015) and Li, Li and Wang (2016) provide evidence of wealth creation to the acquirers frokiym the announcements of cross-border

M&As. On the other hand, Dutta and Puia (1995), Black et al., (2007), Dos Santos, Erunza and Miller (2008), Uddin and Boateng (2009), Nnadi and Tanna (2013) and Drymbetas and Kyriazopoulos (2014) report that CB M&As do not create wealth for the acquirer company shareholders, instead results in significant value destruction.

Studies have also found that there are certain firm specific and deal specific factors which affect the stock price performance of acquirers during the announcement period. One of the significant factors is the industry to which the company belongs to. Kiyamaz and Baker (2008) reported that wealth effects to acquirers range from significantly positive to significantly negative depending on the Industry. To the best of our knowledge, there are no studies in Indian context on the industry effects of CB M&As. Hence in this study we investigate the industry effects of CB M&As by using a sample of 224 CB M&As announced and completed during the period 1st January, 2000 to 20th May, 2016 in India. We found that acquirers from the healthcare and high technology industries gain significantly from the announcement of CB M&As. This study contributes to the extant literature on CB M&As by providing evidence that wealth effects of acquirers varies from significantly positive to negative depending on the industry to which the acquirer belongs to.

In the following we proceed as follows; in the next section we provide the literature review. In the third section we discuss the data and methodology used in this study. Empirical results and discussion have been provided in the fourth section. Finally, fifth section concludes the study.

### Literature review

Being a hot topic, the causes and effects of M&As have been of interest to various researchers all over the world. Vast amount of literature is available with respect to M&As. In this section we focus only on the existing evidence on shareholder wealth effects of acquirers in different industries. Ferris and Park (2001) examined the long-run post-acquisition performance of acquiring firms in the U.S. telecommunications industry. They used an industry and size matched sample of non-merging regulated firms as a benchmark to calculate the change in performance. They found that acquiring firms underperform their size and industry matched control firms. Similarly, Kohers and Kohers (2001) for U.S acquirers that purchase target firms in the high-tech industry report significant erosion in the post-acquisition long-term return. For US M&As during the period 2009-2012, Stunda (2014) reported that firms engaged in M&As in all industry except oil and gas industry along with banking and financial services industry experience negative impact on the stock prices. He also argues that stock price reaction could be different depending upon the industry. Contrary to above studies, Lee and Lim (2006) found that strategic alliance like M&As and joint

ventures create value for companies involved in it. They also reported that value of non IT firms increased more than the value of the IT firms. Their analysis was based on a sample of 170 announcements involving US companies. Likewise, Koenig and Mezick (2004) concluded that post-merger productivity of US pharmaceutical companies improved during the post-merger period compared to the pre-merger period. In the Indian context, Kalghatgi (2012) investigated impact of M&As on the acquirer company shareholders' wealth in the high-technology industry and Jucunda and Sophia (2014) studied a sample of 78 acquisition announcements in the manufacturing industry. Both the studies concluded that the announcement of M&As do not have any impact on the shareholders' wealth. Azhagaiah and Sathishkumar (2014) for a sample of 39 acquirer firms in the manufacturing sector reported that M&As result in the significant positive improvement of operating performance.

A stream of literature has examined the wealth effects of M&As in the financial sector. For example, Sharkas, Hassan and Lawrence (2008) investigated the cost and profit efficiency of bank mergers happened in the U S banking industry during the period 1985 to 1999 using stochastic frontier approach. The sample for their study was 440 banking mergers. They found that cost and profit efficiencies of banks have improved as a result of merger. Similarly, Anand and Singh (2008) and Kumar and Suhas (2010) reported that the merger announcements in the Indian banking industry results in positive wealth effects to the acquirer. On the other hand, findings of Kalra, Gupta and Bagga (2013) were contradictory to the findings of aforementioned studies in the financial sector. They investigated the post-merger performance efficiency in the Indian banking industry by comparing pre-merger and post-merger profitability and liquidity ratios and also by measuring shareholder wealth effects of mergers occurred during the period 2000 to 2011 and reported absence of any significant improvement in the financial performance.

Using 869 acquirers and 795 targets Kiyamaz and Baker (2008) examined the short-term market reaction to the announcement of large domestic M&As involving public U.S firms with public targets from 1989 to 2003. They concluded that the wealth effects of large M&As for the acquiring and target firms can be significantly positive, significantly negative, or not significantly different from zero depending on the industry. These findings shed light on the abundance of existing research on wealth effects of M&As by revealing the importance of industry classification in determining wealth effects for target and acquirer firms. Whether the importance of industry classification in determining wealth effects holds true or not in the case of CB M&As has not got much needed attention of the researchers. For automotive supply industry Mentz and Schiereck (2008) examined the stock price reactions to cross-border M&As by using a sample of 100 horizontal CB

M&As completed during the period 1981-2004 and found evidence of significant wealth creation for acquiring companies involved in the CB M&As. In the Indian context, Srivastava and Prakash (2013) examined whether the cross-border acquisitions result in value creation for the acquirers in the pharmaceutical sector by using 30 cross-border acquisitions by Indian pharmaceutical firms listed on National Stock Exchange and found that CB M&As neither result in improved operating performance nor create value.

There are studies on impact of cross-border M&As on the shareholders' wealth (e.g., Hudgins and Seifert, 1996; Lowinski, Schiereck and Thomas, 2004; Danbolt, 2004; Dos Santos, Erunza and Miller, 2008; Mann and Kohli, 2011; Nnadi and Tanna, 2013; Drymbetas and Kyriazpoulos, 2014; Rani, Yadav and Jain, 2015 a, b; Li, Li and Wang, 2016) and studies have also been done by taking a particular industry (e.g., Mentz and Schiereck, 2008; Srivastava and Prakash, 2013). Nonetheless, evidence on effects of CB M&A announcements on acquirers belonging to different industries is limited, which leaves gap in the literature. Accordingly, this paper examines the wealth effects of CB M&As for acquirers belonging to different industries in India.

#### Data and Methodology

In order to elicit the impact of CB M&As on acquirers from different industries in India, we use a sample of 224 deals announced and completed during the period 1st January, 2000 to 20th May, 2016. CB M&As data are sourced from Thomson ONE database maintained by the Thomson Reuters. Thomson ONE provides detailed information about the M&A deals like date of the announcement, form of the deal, industry of the acquirer and target, acquirer and target nation, public status of the companies involved etc. Stock price data and index data are obtained from

Prowess database maintained by Centre for Monitoring Indian Economy (CMIE). There were 3118 CB M&As during the study period in which acquirer is an Indian company. We used certain criteria to arrive at the final sample for our study. First of all, we eliminated all the deals in which acquirer company is not a public company. Then we eliminated rumoured, pending and withdrawn deals. We also excluded deals involving acquisition of assets and acquisition of shares less than 25%. We then excluded the M&A deals in the financial sector from the sample due to the different nature of assets and liabilities of the financial firms and different financial reporting of these companies (Dos Santos, Errunza and Miller, 2008; Rani, Yadav and Jain, 2013; Narayanan and Thenmozhi, 2014). We also eliminated the M&A deals that are followed within two years of an earlier one to measure the effect of each announcement properly. Finally, those announcements for which enough share price data is not available for conducting event study methodology and deals influenced by confounding events have also been excluded. All these criteria resulted in the final sample of 224 CB M&A announcements. This sample selection process has been depicted in the Table 1.

We categorise the acquirer companies into different industries based on the classification given by Thomson ONE database. Thomson ONE proprietary macro-level industry classifications are based on SIC Codes and there are 14 macro-level classifications comprised of more than 85 mid-level categories. In our final sample, there are companies from 9 different industries. Table 2 provides the industry wise distribution of the sample. Maximum number of CB M&As in our sample belongs to materials industry with 61 deals, followed by high-technology industry with 48 deals.

**Table 1: Sample selection process**

Total number of outbound cross-border M&As involving Indian acquirer during the period 1st January 2000 to 20 <sup>th</sup> May 2016.	<b>3118</b>
<b>Less:</b>	
➤ Cross-border M&As by companies that are not public.	1431
➤ Pending, rumours, intended, status unknown and withdrawn deals.	677
➤ Acquisition of assets and acquisition of less than 25% interest.	535
➤ CB M&As by financial sector companies	16
➤ M&As that is followed within two years of an earlier one.	167
➤ Trading data not available and companies having non-synchronized trading.	32
➤ Confounding events	36
<b>Final sample</b>	<b>(3118-2894) 224</b>

Source: Thomson ONE

**Table 2: Industry wise distribution of sample**

Industry	Number of announcements
Consumer products and services	15
Consumer staples	20
Energy and power	11
Healthcare	24
High technology	48
Industrials	33
Materials	61
Media and entertainment	6
Telecommunications	6
<b>Total</b>	<b>224</b>

Source: Thomson ONE

### Methodology

We employ an event study methodology to draw inferences about the impact of CB M&A announcements on the acquirers from different industries. The impact of a specific unanticipated event related to a company on the wealth of its shareholders is examined with the help of event study methodology (Brown and Warner, 1985; MacKinlay, 1997). In this study, the announcement of CB M&As is considered as the event and the announcement date as provided in the Thomson ONE is defined as the event day ( $t=0$ ). If the announcement day happened to be a trading holiday, next trading day is considered as the event day. The impact of an event is assessed by measuring the abnormal returns (AR). Abnormal returns for each company are calculated as the excess of actual return of company  $i$  on day  $t$ , i.e.,  $R_{it}$ , over the expected return, i.e.,  $E(R_{it})$ .

$$AR_{it} = R_{it} - E(R_{it})$$

Normal return or expected return is the return that would have been received if the event had not taken place. Daily expected returns are calculated using the market model.

$$E(R_{it}) = \alpha_i + \beta_i R_{mt}$$

Where  $\alpha_i$  presents the normal return of the security 'i' when  $R_{mt}$  is 0,  $\beta_i$  measures the sensitivity of company return ( $R_{it}$ ) to the market return.  $R_{mt}$  denotes the market return, in this study, S&P BSE Sensex is used as the market proxy. For each announcement we use the 252 (-282 to -31) trading days, i.e., 282 days before the event day till 31 days before the event day, as estimation period. Market model parameters are computed by an OLS (ordinary least square) regression of company returns ( $R_{it}$ ) on market return ( $R_{mt}$ ) over the 252 days estimation period.

Abnormal returns of companies belonging to each industry are averaged to find out the industry average abnormal return (IAAR) for day  $t$ .

$$IAAR_t = \frac{\sum_{i=1}^N AR_{it}}{N}$$

Where,  $n$  is the total number of sample announcements in a particular industry. In order to measure the overall effect of announcements of CB M&As on acquirers shareholder wealth, we cumulated the IAARs over the 11-day event window (5 days before the day of the announcement until 5 days after the day of the announcement) and computed cumulative industry average abnormal return (CIAAR).

$$CIAAR_{(-5,+5)} = \sum_{t=-5}^{+5} IAAR_t$$

Where,  $CIAAR_{(-5,+5)}$  denotes the cumulative industry average abnormal returns during the 11-day event window.  $IAAR_t$  denotes industry average abnormal returns during day  $t$ .

In order to test the statistical significance of IAARs and CIAARs we follow parametric test proposed by Brown and Warner (1985). This test examines the null hypothesis that IAARs and CIAAR are not statistically different from zero. Statistical significance of IAARs on each day is tested using the following formula

$$t_{IAAR} = \frac{IAAR_t}{(\sigma_{IAAR})}$$

Where;

$IAAR_t$  = Industry average abnormal return on day 't' in the event window

$\sigma_{IAAR}$  = Standard deviation of IAAR during the estimation period

To comment on the significance of CIAAR during the 11-day event window, following test statistic has been used.

$$t_{CIAAR} = \frac{CIAAR_{(-5,+5)}}{(\sigma_{IAAR} * \sqrt{T})}$$

Where T is the number of days over which IAARs are cumulated 11 days in this study IAARs the standard deviation of IAARs over the estimation period 282 to -31).In addition, for ensuring the robustness of the result we also use one non-parametric test, i.e., generalized sign test, proposed by Cowan (1992). Non-parametric statistics do not require assumptions about return distributions as in the parametric tests. “ The generalized sign test examines whether the number of stocks with positive cumulative abnormal returns in the event window exceeds the number expected in the absence of abnormal performance” (Cowan, 1992). The number expected is based on the proportion of positive abnormal returns in the 252 day estimation period.

$$\hat{p} = \frac{1}{n} \sum_{j=1}^n \frac{1}{252} \sum_{t=1}^{252} S_{jt}$$

Where,  $\hat{p}$  is the proportion of positive ARs in the estimation

period.

$$S_{jt} = \begin{cases} 1 & \text{if } AR_{it} > 0 \\ 0 & \text{otherwise} \end{cases}$$

Value of generalised sign test has been obtained using the following formula.

$$Z_G = \frac{w - n\hat{p}}{\sqrt{n\hat{p}(1 - n\hat{p})}}$$

Where, w is the number of stocks in the event window for which cumulative abnormal return (for testing significance of CAARs) or abnormal returns (for testing the significance of AARs) is positive.

### Results and Discussion

In this section we discuss the empirical results and findings of the study. Using event study methodology we investigate the impact of CB M&A announcements on acquirers from different industries in India. The results of event study methodology have been provided in the Table 3 and Table 4. Table 3 presents the IAARs on the day of the announcement and the results of parametric and non-parametric tests.

**Table 3: IAARs on the day of the announcement**

Industry	IAARs	t value	G Sign test (Z)
Consumer products and services	1.52%	1.807	2.113*
Consumer staples	-0.66%	-0.962	-0.062
Energy and power	1.91%	2.327*	1.142
Healthcare	1.33%	2.439*	1.304
High technology	2.10%	3.917**	2.237*
Industrials	2.09%	4.668**	3.231**
Materials	-0.10%	-0.286	-0.433
Media and entertainment	1.70%	1.303	1.044
Telecommunications	1.6%	1.465	1.024

Source: Authors' computation

Note: \* and \*\* indicate significance at 5% and 1% level of significance respectively

It is apparent from the table that the impact of CB M&A announcements on acquirers from different industries are not the same. Consumer staples industry and materials industry experience insignificant negative returns on the day of the announcement. On the other hand, consumer products and services industry, media and entertainment industry and telecommunications industry experience insignificant positive returns. Interestingly, we observe significant positive returns for acquirers from the energy and power, health care, Industrials and high-technology industries on the day of the announcement. Highest returns are reported for the high-technology and Industrials with IAARs of 2.10% and 2.09% respectively. Both the parametric and non-parametric tests show that IAARs are statistically

significant for Industrials and high-technology industries. Energy and power industry and healthcare industry experience significant and positive returns of 1.91% and 1.33% respectively on the day of the announcement. Analysis of returns on the day of the announcement shows that, returns are positive and significant only for acquirers from the energy and power, health care, Industrials and high-technology industries.

The overall impact of CB M&A announcements on acquirers across different industries has been measured by observing the statistical significance of CIAARs during the 11-day event window. Table 4 presents the wealth effects associated with CB M&As across industry groups during the 11-day event window.

**Table 4: CIAARs during the 11-day event window**

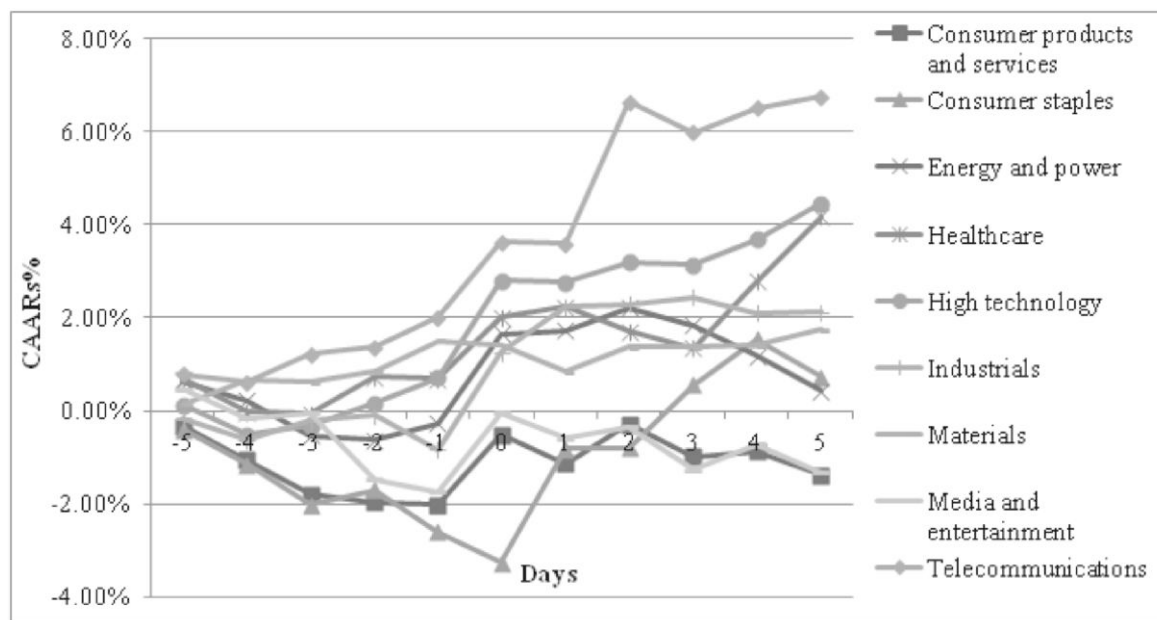
Industry	11-Day CIAARs	t value	G Sign test (Z)
Consumer products and services	-1.38%	-0.497	0.041
Consumer staples	0.73%	0.322	-0.062
Energy and power	0.42%	0.154	-0.067
Healthcare	4.17%	2.312*	2.124*
High technology	4.46%	2.506*	1.658
Industrials	2.12%	1.428	0.781
Materials	1.75%	1.470	0.596
Media and entertainment	-1.32%	-0.307	0.225
Telecommunications	6.8%	1.847	1.844

Source: Authors' computation

Note: \* and \*\* indicate significance at 5% and 1% level of significance respectively

Table 4 shows that CIAARs are positive and significant during the 11-day event window for the acquirers from the healthcare and high technology industry. Healthcare and high technology industry experience positive CIAARs of 4.17% and 4.46% respectively. Consumer staples (0.73%), energy and power (0.42%), industrials (2.12%), materials and telecommunication (6.8%) industries experience insignificantly positive returns. On the other hand, acquirers experience insignificantly negative CIAARs in consumer

products and services industry (-1.38%) and media and entertainment industry (-1.32%). These findings suggest that the wealth effects of CB M&As for the acquirers differ across industries. To put it in simple words, the wealth effects of CB M&As for the acquirers can be significantly positive, insignificantly positive or insignificantly negative depending on the industry. The trend of CIAARs during the 11-day event window has been depicted in the Figure 1.

**Figure 1: Trend of CIAARs during the 11-day event window**

Source: Authors' computation

Although acquirers from energy and power, health care, industrials and high-technology industries experience significantly positive returns on the day of the announcement, the results involving the 11-day event window show that CB M&As result in statistically

significant abnormal returns only in the healthcare and high-technology industry. Companies in the healthcare industry have been crossing the borders to acquire the overseas companies. The strategy of CB M&As helps healthcare companies in acquiring new product portfolios, brands,

research laboratories and technologies to overcome their technological deficiencies and strengthen their innovative capabilities (Jayanthi, Sivakumar and Haldar, 2016). Certainly the spate of CB M&As in the healthcare sector since 2000 (UNCTAD, 2006) coupled with the economies of scale in R&D (Koenig and Mezick, 2004) and other benefits indicate that healthcare industry sees advantages in CB M&As. Our findings uphold this argument by showing significantly positive wealth creation for the acquirers in the healthcare industry. The results also show that high technology firms are able to generate higher wealth for the acquirers from the announcement of CB M&As. High technology industry encompasses a number of different industries, from bio-technology to information technology to electronic devices. Focus on innovation is the key characteristic of all these different areas (Kohers and Kohers, 2001). A large number of CB M&As in India primarily involve technology intensive industry in which India has a high competitive advantage (Nicholson and Salaber, 2013). The finding of this study shows that the market sees CB M&As in the high-technology industry as value creating.

### Summary and conclusions

This study assesses the wealth effects of CB M&A announcements for acquirers belonging to different industries by employing event study methodology. Using a sample of 224 CB M&As announced and completed by companies belonging to different industries during the period 1st January, 2000 to 20th May, 2017, we find that the wealth effects of CB M&As for the acquirers differ across industries. The wealth effects of CB M&As for the acquirers can be significantly positive, insignificantly positive or insignificantly negative depending on the industry. Based on the CIAARs during the 11-day event window, this study shows that CB M&As result in statistically significant abnormal returns only in the healthcare and high-technology industry. Acquirers from the healthcare and high technology industries experience significantly positive CIAARs of 4.17% and 4.46% respectively during the 11-day event window. This finding corroborates the large number of CB M&As taking place in the healthcare and high technology industries in India to obtain strategic assets. The findings of this study are in line with the findings of Kiyamaz and Baker (2008), they also document that the wealth effects of large domestic M&As in U.S for the acquiring and target firms differ depending on the industry. We contribute to the existing literature on CB M&As by revealing the importance of industry classification in determining the presence of wealth effects. We also document that in an emerging country like India, technology and innovation oriented industries like healthcare and high technology are able to create value by venturing abroad.

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