

**MERGERS AND ACQUISITIONS:
A STUDY OF SHORT-TERM ABNORMAL
RETURNS, LONG-TERM FINANCIAL
PERFORMANCE AND CORPORATE
GOVERNANCE**

by

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Submitted

**in fulfilment of the requirements of the degree of
Doctor of Philosophy**

to the



**Indian Institute of Technology Delhi
Hauz Khas, New Delhi – 110016, India
March 2013**

CERTIFICATE

The thesis titled, “**Mergers and Acquisitions: A Study of Short-Term Abnormal Returns, Long-Term Financial Performance and Corporate Governance**”, being submitted by Ms. Neelam Rani to the Indian Institute of Technology, Delhi, for the award of the degree of Doctor of Philosophy (Ph.D.) is a record of bonafide research work carried out by her. She has worked under our guidance and supervision, and has fulfilled all the requirements for the submission of this thesis, which has attained the standard required for a Ph.D. degree of this institute. The results presented in this thesis have not been submitted elsewhere for the award of any degree or diploma.

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ACKNOWLEDGEMENTS

This thesis is dedicated to my parents for giving me the willpower to pursue what I believed in.

The thesis would not have been possible without my respected supervisors and Gurus Prof. Surendra S. Yadav and Prof. P. K. Jain. I would like to express my sincere gratitude to both for their valuable insights, guidance, motivation and untiring efforts to develop an independent researcher out of me. They have been a source of constant inspiration and courage at every stage of my research work, their multifarious duties notwithstanding.

I would like to extend my sincere indebtedness to Prof. Sushil, Prof. V. Upadhyaya (Department of Humanities), Dr. Seema Sharma, Prof. Kanika T Bhal and all the faculty members of Department of Management Studies who spared their valuable time for providing useful inputs in this research endeavour.

I would like to express my sincere gratitude to United States Education Foundation of India for giving me an opportunity through Fulbright Nehru Fellowship to learn at Rutgers Business School, Newark, as visiting research scholar. I would like to extend my sincere indebtedness to Prof. Simi Kedia, Prof. Ivan Brick, Dr. Rose Liao and all the faculty members of Finance and Economics at Rutgers Business School, Newark, who spared their valuable time for providing useful inputs in this research effort during my stay there.

I am grateful to Prof. G Sethu, (Officer on Special Duty, in charge, National Institute of Securities Markets), Mr. M. Damodaran (SEBI), Mr Amarjit Singh (SEBI), Ms. Neelam Bhardwaj (SEBI), Ms. Soma Majumdar (SEBI), Mr. H. S. Sidhu (CEO, Delhi Stock Exchange) and Mr. Gopala Krishnan Aiyer (Bombay Stock Exchange) for

providing support for framing questionnaire and collection of primary data. They went out of the way to provide me support to conduct survey on corporate governance- an arduous task for a student. They always extended their help with a smile.

I am deeply obliged to Mr. Amar Gill, Head Asia Research, CLSA, for providing me his guidance and useful insights in framing the Questionnaire.

I am thankful to all the respondents of the survey, who took out time from their busy schedules to provide their responses to the questionnaires.

I am extremely grateful to Mr. Manoj Vasudev, for standing by me in my tough times.

I express my sincere thanks to Ms. Mohita Maggon, Ms. Neetu Yadav and Mrs. Rejani Raghu for their continuous support.

I am extremely grateful to Mr. Arjun Dev (Registrar, Education Department, Chandigarh Administration, Chandigarh) for his continuous encouragement and support throughout this research study.

I take this opportunity to thank my family and all my friends who understood my need to do this work and forgave my absence from their lives.

Lastly, I am most thankful to my brothers Sunil and, especially, Vipin for being my pillar of strength at all times. Their continuous encouragement, support and guidance at every step made this work possible. And last, but not the least, my sisters Sapna and Amita who have been highly understanding during my research work.

Date: March 28, 2013

(Neelam Rani)

ABSTRACT

Mergers and acquisitions (M&A) have long been an important component of corporate strategy. They represent an important alternative for strategic expansion. Acquisitions as growth strategy have received attention from developed as well as emerging economies. They have been extensively used by managers as an expansion strategy. Mergers and acquisitions also serve as an important instrument of corporate governance to increase corporate efficiency. Mergers and acquisitions are well-suited events where corporate values are tested over time. Globalization and liberalization have led firms from emerging markets like India to become more aggressive and opt for mergers and acquisitions to fight the competitive battle. Recently, mergers and acquisitions have grown at a rapid pace, which calls for research to analyze what drives firms for this phenomenon and how it affects firms and markets.

The present study attempts to evaluate the impact of mergers and acquisitions on the returns in short- term as well as long- term. For the purpose, well-established research techniques, namely, event study methodology and two experimental designs viz. ‘before-and-after design’ and ‘after-only design’ have been used. Besides these techniques, two surveys have also been conducted for top-level Indian corporate managers of the organizations that adopted the strategy of M&A. The surveys aim to gauge the managerial views about the corporate governance practices and the motives of mergers and acquisitions. The findings of the surveys are corroborated with the secondary data analysis.

The notable finding of the research is that market starts reacting prior to the announcement. The moment the announcement information becomes public, investors start reacting and the stock price jumps high, providing positive abnormal returns to

the investors. “EARLIER HE SELLS, MORE HE GAINS” is the major finding of short-term abnormal returns. Cross-border as well as domestic acquisitions have created value for shareholders of the acquirer company on the announcement. The results indicate that value creation is higher for cross-border acquisitions vis-a-vis domestic acquisitions. The acquisitions financed with cash experience higher returns than the acquisitions financed with stock; “ISSUANCE OF STOCK FOR M&A IS NOT GOOD NEWS”. The acquirer of unlisted target firms experience higher return than the acquirers of listed target firms. The acquirer earns when target remains as a wholly-owned subsidiary (WOS). In contrast, the acquirer shareholder loses when the target firm is absorbed with the operations of the acquiring firm. The acquisitions of targets from non-US developed market outperform the return from the acquisition of US targets.

Survey findings reveal that the primary motive of mergers in India during 2003-2008 has been to take advantage of synergies. Operating economies, increased market share and financial economies (lower risk leading to lower cost of capital) have been indicated in order of importance as the desired synergies to be gained through corporate mergers and acquisitions in India.

M&A appear to have been financially beneficial for the acquiring companies. The findings suggest that profitability of acquiring firms has improved during post-M&A phase. Better management of liquidity position during the post-M&A period has also been observed. M&A has no impact on the leverage of acquiring firms before and after M&A. Operating profit margin based on sales have improved post-M&A. The significantly higher post-M&A operating margin indicates that the acquirers appear to have generated higher operating profit per unit net sales, post M&A. The better operating margin seems to be due to the lower costs as a result of economies of scale.

Negative mean difference of expense ratio also corroborates this finding. The efficiency of utilization of assets to generate higher sales does not appear to have improved.

Practice of corporate governance has progressed in a big way in Indian companies as revealed by their mean score; mean corporate governance score has also improved over time. There are several companies which made proactive initiatives in introducing good governance norms and standards even before these became mandatory. Companies in the bottom quartiles are those that comply with the minimum mandatory standards of corporate governance. Companies in service sector have better corporate governance score. There is a positive association between corporate governance score and shareholders' wealth due to announcements of mergers and acquisitions. Companies with better corporate governance create higher shareholders wealth in short-term. Companies having higher corporate governance score show better financial performance on the basis of all measures of rate of return. Companies with higher corporate governance score show better valuations.

Based on the findings of the research study, the following recommendations have been made for the investors: (i) "EARLIER HE SELLS MORE HE GAINS" and "ISSUANCE OF STOCK FOR M&A IS NOT GOOD NEWS". (ii) An investor can also earn substantial returns if the shares of the acquiring company are purchased two days prior to the announcement day and sold two days after the announcement day. (iii) The announcement of cross-border acquisitions provides much higher returns than that for domestic. In addition, the cumulative abnormal returns in the case of cross-border acquisitions are permanent while they are temporary in the case of domestic acquisitions. (iv) The announcement of complete acquisitions of target firm as a wholly-owned subsidiary provides much higher returns than that for partial/

majority control acquisitions. In addition, the cumulative abnormal returns in the case of complete acquisitions are permanent while they are temporary in the case of partial/majority control acquisitions. (v) The announcement of acquisitions financed with cash payment provides substantial returns. (vi) As far as agency costs are concerned, investments in companies with better corporate governance score are more profitable.

Based on the findings of the research study, the following recommendations have been made for the corporate managers and policy makers: (i) The study suggests that the Indian managers adopt mergers and acquisitions as effective strategy for corporate growth. It brings attention of the managers to consider cross-border as well as domestic acquisitions as an option to strengthen their competitiveness as the effects of these announcements appear to be a good indicator of longer-term success. (ii) Managers should think of cash as a mode of payment to finance mergers as issuance of shares is bad news. (iii) The management may acquire the target firm as a subsidiary and may absorb it with its own operations later on. (iv) The management should be aware of the need for efficient corporate governance structure and mechanism to control information asymmetry. (v) The findings that firm performance is significantly influenced by effective corporate governance could serve to justify regulatory measures and towards enforcing healthy corporate governance regime and initiatives to encourage corporate to adopt and adhere to these measures.

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