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**Chh. Shahu Institute of Business  
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## Editorial Note

*Humor has a unique place in literature, particularly in English literature. Mark Twain, a great Humorist, stated that humor is a great thing, the saving thing, the minutes it crops up, all our irritations and resentments slip away and a sunny spirit it takes their place. Humor is the tendency of particular cognitive experience to provoke laughter. Humor is a broad term that refers to anything that people say or do that is perceived as funny and tends to make others laugh, as well as the mental processes that go into both creating and perceiving such as an unusual stimulus and also the affective response involved in the enjoyment of it stated by Rob H. Martain in his book Psychology of Humor.*

*The etymology of humor began as a Latin word humors means fluids or liquids. It has a medical connotation. Bharata Muni's Natya Shatra contains humor as one of the nine Navarasa in which it is known as 'Hasya'.*

*Whether we can use humor effectively in day today activities of the Management? The business cartoon caricatured by Scot Adams appeared in the name of Dilbert induces laughter at worker place. Some of his quotations are worth remembering. They are I can only please one person per day. Today is not your day. Tomorrow is not looking either good. Change is good but you go first. Another business cartoon worth remembering is Mario Mirands business cartoons.*

*Defiantly, humor has a place in practicing management. Humor has become a recognized asset in the work place. It facilitates communication, builds relationship, reduce stress and induces creativity.*

*Humor at a workplace is often associated with stress. Stressful employee cannot perform effectively. Humor is greatest stress reliever. Godfrey in the Journal of Women's Health Stated that, "Humor is potentially effective means of coping with the anger. Further he stated that, "One must be careful with its use". Sarcastic or hostile humor can incite additional anger.*

*A sense of humor is apparent among creative people. Research reflects that creativity and humor is associated with each other. Creative people display interest in humor and also capacity in producing original humor thought. Getzeles and Jackson stated that when ranking a series of desirable traits creative students placed a sense of humor second, whereas of the same intelligence but less creativity ranked it lowest among all the desirable traits. When both groups drew pictures of various themes, over half of the creative students made drawings judged as humorous, and their essay showed the same tendency.*

**Dr. Babu Thomas**  
**Editor**

# Shareholder Wealth Gains in Corporate Merger Announcements in India

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## Abstract

The present work analyses the merger announcement effects from the view point of Indian acquiring and target firms. Employing a broad-based sample of acquiring firms, the study finds negligible (0.008%) returns on announcement and negative overall CAR (2.79%) to the shareholders of acquiring firms in a 41-day event. Though the merger announcement generates positive returns, the overall CAR (10.39%) is negative for the shareholders of the target firms. The 3-day window generates positive returns to the shareholders of both the firms. The target shareholders earn a CAR of 4.38% while the acquiring shareholders earn 0.64%. Since returns due to merger announcements are highly transient in India and shareholders of merging firms are better off by selling shares immediately rather than holding them.

**Key words:** Abnormal Returns, Acquisitions, Market Model, Mergers, Window Period

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## 1. Introduction

Do mergers generate abnormal returns to shareholders? This question has occupied a lot of academic space in research studies carried out in the US and other countries. By and large the conclusions show that mergers are beneficial to the shareholders of target firms than to the acquiring firms. The shareholders whose company is bought end up richer, while the shareholders of the buyer seldom do (Bogan and Just, 2006). Target shareholders earn significantly positive abnormal returns from all acquisitions and acquiring shareholders earn negative abnormal returns from mergers (Loughran and Vjih, 1997). In the short-term to medium term, fewer than half of all mergers add value (Bogan and Just, 2006).

Despite these high risks involved, the mergers have not shown any decreasing trend the world over. The US has witnessed merger waves at frequent intervals while in other countries the mergers are on the rise. Mergers in India, too, are following the lead of the global trend in mergers. The liberalisation policies unleashed since 1991 have resulted in business consolidation and streamlining through the process of M&A. Indian firms are acquiring not only local firms but have developed a big

appetite for the cross-border deals. The Tata Steel acquisition of British-based Corus Steel is a best example followed by Hindalco acquisition of the US-based Novelis. The total value of M&A and Private Equity deals announced in 2008 was \$41.54 billion which decreased to \$21.2 billion in 2009. There were 766 deals in 2008 and 488 in 2009. Forty per cent of total deals were outbound deals in India in 2009.

In view of the growing number of merger announcements in India, it becomes incumbent to ascertain the excess returns involved in merger announcements. Do all the merger announcements generate positive returns for both the acquiring and target firms' shareholders? Though several studies in India have examined the announcements returns, the present study makes a comprehensive computation for both the acquirers and the target firms over long and short event windows.

The paper is organised into several sections. In Section 2 a review of the literature is given followed by the description of sample and methodology in Section 3. Section 4 gives the analysis of the results of the study. Section 5 concludes.

## 2. Review of literature

The phenomenon of corporate mergers has always been a complex one. The financial research in mergers has attempted to analyse this phenomenon with a view to identify the rationale involved in mergers, gains to acquiring and target firms, post-merger performance of acquiring firms, risks involved in mergers, determinants of merger activity, financing policies employed, merger waves, etc.

Jensen and Ruback (1983) argue that mergers and acquisitions create social welfare by allowing the most efficient distribution of corporate assets. They report that successful acquiring firms earn an average risk-adjusted excess return of 3.8% in acquisitions and approximately 0% in mergers. However, these results were challenged by a flood of event studies finding negative returns to the shareholders of acquirers during 1970s and 1980s. Generally these studies demonstrated that the mean returns to acquirers pursuing acquisition strategies were significantly negative, with only approximately 35% of acquisitions being met with positive market returns on announcements (Bogan and Just, 2006).

Cummins and Weiss (2004) analyze M&As of European insurance industry over the period 1990-2002 and find that European mergers and acquisitions created small negative cumulative average abnormal returns (CAR) for acquirers and substantial positive CAR for targets. Moeller et al. (2005) examine a sample of 12,023 acquisitions by public firms from 1980 to 2001 and find that shareholders of these firms lost a total of \$303 billion when acquisitions were announced, i.e. -\$25.2 million per acquisition. The study finds that the acquisitions by small firms are profitable for their shareholders, but these firms make small acquisitions with small dollar gains. Large firms make large acquisitions that result in large dollar losses. Acquisitions thus result in losses for shareholders in the aggregate because the losses incurred by large firms are much larger than the gains realised by small firms. Roughly, shareholders from small firms earn \$9 billion from the acquisitions made during the period 1980-2001 whereas the shareholders from large

firms lose \$312 billion.

Most merger event studies find that, in the long-term, acquiring firms are found to experience negative abnormal returns (Scherer, 1988). Franks et al. (1991) find no evidence of significant abnormal returns over a three-year period after the last bid date. However, Agarwal et al. (1992) find that tender offers are followed by insignificant abnormal returns, but mergers are followed by significant abnormal returns of -10% over a five-year period after the effective date.

A number of explanations have been offered as to why the stock price of firms announcing an acquisition can be negative. Roll (1986) hypothesizes that managers of bidding firms may suffer from hubris, so they overpay. Travlos (1987) points out that firms with poor returns generally pay with equity, and Myers and Majluf (1984) show that firms that issue equity signal that the market overvalues their assets in place (the equity signalling hypothesis). A related hypothesis, formalised by McCradle and Vishwanathan (1994) and Jovanovic and Braguinsky (2002), is that firms make acquisitions when they have exhausted their internal growth opportunities (the growth opportunities signalling hypothesis). Jensen (1986) argues that empire-building managements would rather make acquisitions than increase payouts to shareholders (the free cash flow hypothesis). Recently, Dong et al. (2002) show that firms with higher valuations have worse announcement returns. This could be because highly valued acquirers communicate to the market that these high valuations are not warranted by fundamentals, perhaps because they are undertaking efforts to acquire less overvalued assets with more overvalued equity (the overvaluation hypothesis). Finally, Mitchell et al. (2004) show that there is a price pressure effect on the stock price of the bidder for acquisitions paid for with equity because of the activities of arbitrageurs (the arbitrage hypothesis).

Several studies have related method of financing mergers and merger success. A firm may use cash or shares or a combination of these two in financing mergers and acquisitions. In a world where managers possess private information that shareholders do not, Myers and

Majluf (1984) show that a firm will issue stock only when it is overvalued. It follows that firms will prefer to pay cash if their stock is undervalued. Loughran and Vijh (1997) classify their sample of 947 firms on the basis of the mode of acquisition (mergers or tender offer) and the form of payment (stock or cash). Both variables have been examined in the context of wealth gains from acquisitions. The mode of acquisition may be related to the expected wealth gains resulting from operating synergies and the disciplining of target managers. Mergers are usually friendly deals that enjoy the co-operation of incumbent managers. Tender offers are made directly to target shareholders, often to overcome resistance from incumbent managers and indicate greater confidence in the acquirer's ability to realise efficiency gains from the acquisition. In the overall sample of 947 cases, acquirers that make merger bids earn, on average, 15.9% less than matching firms whereas acquirers that make tender offers earn an 43% more than matching firms during a 5-year period after acquisition. Similarly, stock acquirers earn 24.2% less than matching firms whereas cash acquirers earn 18.5% more than matching firms.

Martin (1996) shows that the form of payment is partly endogenous to the mode of acquisition. Mergers are more often financed with acquirer's stock whereas tender offers are predominantly cash financed. The study also shows that stock acquirers have lower book to market ratios and a superior historical growth record, which raises the possibility that the acquirers' managers may become overly optimistic about their firm's growth opportunity. Fishman (1989), Berkovitch and Narayanan (1990) and Eckbo et al. (1990) expand on this idea and show that higher valued bidders will use cash or a higher proportion of cash to signal their value to the market. However, if the bidder is uncertain about the target's value, the bidder may not want to offer cash, since the target will only accept a cash offer greater than its true value and the bidder will have overpaid.

Fuller et al. (2002) study shareholder returns for firms that acquired five or more public, private and/or subsidiary targets within

a short-time period. Using a sample of 3,135 takeovers, they find that bidders have significantly negative returns when buying public targets and significantly positive returns when buying private or subsidiary targets. When the bids are partitioned on method of payment, they find that acquisitions of public targets result in insignificant bidder returns for cash or combination offers but significantly negative returns to the acquirers when stock is offered. However, for private and subsidiary targets, acquirer returns are significantly positive regardless of the method of payment. These acquirer returns accompanying bids for private firms and subsidiaries are greater for bids financed with equity than for bids financed with cash.

Several empirical studies have been carried out in India on various aspects of mergers, like announcement returns, long-term share price performance, post-merger effects, characteristics of firms involved in mergers, effect of industrial shocks on merger performance, etc. Bhaumik and Selarka (2008) find that, on an average, M&A in India results in reduction in firm performance. Taking a sample of unrelated firms of the period 1995-2002 the study shows that the mergers neither add to the profitability of the firms nor create value for shareholders. Employing a merger sample of 56 firms for the period 1994 to 2002, Singh and Mogla (2008) compare pre and post-merger performance of merged companies. The study finds a decline in the post-merger performance of merged companies. However, they find that the profitability of matching firms also declined significantly over the same period and conclude that the decline in profitability cannot be attributed to mergers alone.

Pawaskar (2001) analyse the post-merger performance of acquiring firms in India based on a sample of 36 mergers in the period 1992 to 1995 and find no improvement in post-merger performance of acquiring firms. The study finds an increase in leverage as the only significant gain to the acquired firms. Satish Kumar and Bansal (2008) observe an improvement in financial performance in only 60% of the acquisition cases in post-merger period. Pathak and Mishra (2006) analyse the merger effect on market power of acquiring firms in

Pharmaceutical Industry and find no evidence of market power synergy to combined firms. Vanitha and Selvam (2007) and Mantravadi and Reddy (2008a) analyse the merger effect on the financials of the acquiring firms on similar lines. Vanitha and Selvam (2007) find no change in the overall financial performance of merged companies in respect of 13 variables taken for the study. On the other hand, Mantravadi and Reddy (2008a) find a fall in the six financial variables selected by the study for evaluating post-merger performance of acquiring firms. In another study, Mantravadi and Reddy (2008b) analyse post-merger performance over 6-year period for horizontal, vertical and conglomerate mergers in India. The study finds a fall in operating profit margin, gross profit margin, net profit margin, ROE and ROCE for all the three types of mergers in post-merger period.

Agarwal and Bhattacharjea (2006) analyse the influence of industry and regulatory shocks on merger activity in India. The study finds clustering of merger activity at industry levels in response to industry and regulatory shocks. The repeal of Monopolies and Restrictive Trade Practices Act had positive and significant effect on merger behaviour of firms in India. Agarwal and Sensarma (2007) investigate the role of industry level factors in determining merger activity in an emerging economy. The results from logistic and count data regressions suggest that growth opportunity, concentration and cash flow are important determinants of merger activity. Rajesh Kumar and Rajib (2007) analyse the characteristics of acquiring and target firms employing a sample of the period 1993-2004. They find that acquiring firms have higher cash flow, P/E ratios, book value, liquid assets and lower debt to total assets which are statistically significant when compared to target firms. The acquired firms were smaller and had lower P/E ratios, dividend payouts and growth in sales and assets.

Mishra and Goel (2005) analyse returns to the shareholders in RIL and RPL merger for 41-day event window. The study finds overall negative returns for both the firms. Though the announcement day AAR for RIL was 0.81% and for RPL it was 4.98%, the announcement day CAR is -4.48% and -3.97% for RIL and

RPL respectively. The overall CAR for RIL was negative at -3.54% while it is positive for RPL at 0.39%. Manoj and Singh (2008) analyse the wealth effect of five mergers in the Indian banking sector and find positive and significant wealth effect for bidder and target banks. In a major study on wealth creation by merger announcements, Rajesh Kumar and Panneerselvam (2009) analyse the announcement returns from the point of view of acquiring and target firms employing a sample of 252 acquirer and 58 target firms involved in acquisitions, and 165 acquirer and 18 target firms involved in mergers for the period 1998-2006. The study finds that mergers create more benefits for target firm shareholders than for acquiring firms. The 3-day CAR is 10.3% for target firms as against 1.79% for acquiring firm investors. On the other hand, under the acquisition situation the gains are limited to both types of firms; the 3-day CAR being 1.15% for acquirer and 0.07% for target firms. Gupta (2008) analyses the merger effect on the wealth of target firms' shareholders and finds a positive AAR of 0.68%, significant at 5% for 30 sample target firms. The announcement day CAR and overall CAR are also positive and are estimated at 9.47% and 4.55% respectively.

In conclusion, it can be said that the empirical analysis in India yields results on similar lines, i.e., mergers create more gains to the target firms' shareholders than to acquirer firms and that the post-merger operating and financial performance of combined entity is not satisfactory. The present study is an extension of such an analysis to a larger sample size of mergers of recent years. The main objective of the study is to find the short-term returns to the shareholders of both acquiring and target firms. It employs both short and long-windows, namely, 41-day and 3-day and would seek to test the wealth gains to the shareholders in both the windows. Such an analysis could help shareholders to devise an appropriate strategy for value maximisation. Positive returns in both the windows would mean that shareholders gain more by holding the investment in merging firms or by increasing the exposure. On the other hand, gains only in short-window would help the shareholders to minimise the losses by exit option.

Where

$$S(AR_{jt}) = \sqrt{\sum_{\tau=-220}^{\tau=-21} (AR_{jt} - AR_j)^2 / 200}, \quad \text{and}$$

$$AR_j = \frac{1}{200} \sum_{\tau=-220}^{\tau=-21} AR_{jt}$$

The test statistic for any given day is given by

$$Z_t = \sum_{j=1}^{N_t} AR_{jt} / (N_t)^{-1/2}$$

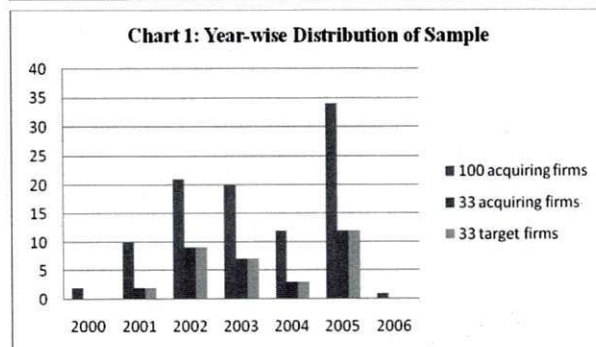
Assuming that the standardized excess returns are independent and identically distributed with finite variance, Z is distributed standard normal for a large  $N_t$ .

#### 4. Analysis of Results

Table 1 shows the year-wise distribution of sample of merger firms. The sample includes more mergers of the period 2002 to 2005, i.e., almost 87% of the total sample size. Chart 1 shows the pictorial depiction of the distribution of the sample:

**Table 1 : Year-wise Distribution of Sample Firms**

Year	No. of Mergers		
	100 Acquiring	33 Acquiring	33 Target
2000	2	-	-
2001	10	2	2
2002	21	9	9
2003	20	7	7
2004	12	3	3
2005	34	12	12
2006	1	-	-
<b>Total</b>	<b>100</b>	<b>33</b>	<b>33</b>



#### 4.1. Announcement Returns for 100 acquiring firms

Table 2 shows the abnormal returns on account of merger announcements in India for 100 sample acquiring firms for 41-day event period.

**Table 2 : Announcement Returns of Mergers in India**

Window period	AAR (%)	t-test	CAR (%)	% of Cos with +ve AAR
-20	-0.40	-0.32	-0.40	42
-19	0.23	1.51	-0.16	54
-18	-0.23	0.37	-0.40	46
-17	0.02	2.08**	-0.38	50
-16	-0.05	0.36	-0.42	45
-15	-0.35	0.49	-0.77	50
-14	0.44	2.25**	-0.34	54
-13	-0.06	1.00	-0.40	46
-12	0.21	2.44**	-0.19	56
-11	-0.56	-0.12	-0.75	39
-10	0.10	1.34	-0.65	50
-9	-0.21	1.40	-0.86	50
-8	-0.53	0.03	-1.39	49
-7	0.61	2.52**	-0.78	55
-6	-0.17	-0.38	-0.95	47
-5	0.16	0.56	-0.78	47
-4	0.18	0.80	-0.61	52
-3	-0.38	-0.19	-0.98	48
-2	0.22	1.64***	-0.76	49
-1	-0.03	0.84	-0.80	49
<b>0</b>	<b>0.008</b>	<b>1.73***</b>	<b>-0.79</b>	<b>53</b>
1	0.11	1.52	-0.68	51
2	-0.43	-0.009	-1.11	46
3	-0.46	-0.39	-1.58	42
4	-0.11	0.19	-1.68	45
5	-0.36	-0.72	-2.04	43
6	-0.18	-0.32	-2.23	40
7	-0.64	-0.70	-2.86	43
8	0.04	0.62	-2.82	40
9	-0.34	0.16	-3.16	43
10	-0.27	0.36	-3.43	45
11	-0.07	-0.02	-3.50	41
12	0.82	2.53**	-2.69	56
13	-0.02	0.30	-2.71	47
14	0.05	2.15**	-2.66	53
15	-0.20	1.52	-2.86	56
16	0.004	0.71	-2.86	50
17	0.37	1.24	-2.48	46
18	0.24	1.03	-2.24	56
19	-0.45	0.17	-2.69	43
20	-0.10	1.32	-2.79	47
<b>Avg</b>	<b>-0.07</b>	<b>0.78</b>	<b>-1.53</b>	
<b>Std dev</b>	<b>0.32</b>	<b>0.93</b>	<b>1.07</b>	
<b>Sqrt</b>	<b>0.03</b>	<b>0.093</b>	<b>0.11</b>	
<b>t-test</b>	<b>-2.13</b>	<b>8.42*</b>	<b>-14.34</b>	

\*, \*\* and \*\*\* indicate significance at 1%, 5% and 10% levels respectively



The market reaction to merger announcements by acquiring firms in India is almost negligible. In other words, there is neither gain in wealth nor loss of wealth i.e., mergers are value neutral. The AAR is 0.008%, significant at 10% level. This is in conformity with the results observed in other countries, that mergers do not create any wealth to the shareholders of acquiring firms. The most of the broad-based, risk-adjusted studies on mergers (Mandelkar, 1974; Langetieg, 1978; Dodd, 1980, Asquith, 1983) show that the shareholders of bidding firms either gain a small statistically insignificant amount or, in the study by Dodd (1980) lose a small significant amount from the announcement of a merger bid.

The lack of returns to the bidding firms' shareholders could mean that the market is fully efficient and reflects the total information. There is evidence to this effect as AAR is positive on 5<sup>th</sup>, 4<sup>th</sup> and 2<sup>nd</sup> day in pre-announcement period. However, it is very difficult to argue that the market reflects fully all the merger related information. The lack of market reaction could also mean the market's disinterest in merger announcements or lack of difficulty to comprehend or understand the synergy effects of mergers. It would also mean that the market for mergers is perfectly competitive and the existence of competitive bidders drive away all the synergy gains from the ultimate winners by extracting the maximum price to the target firms. Weston et al. (2001) note that zero returns to bidders are consistent with a competitive corporate control market in which firms earn 'normal' returns in their operations.

The CAR on the announcement day as well as for the entire event period is negative, i.e., -0.79% and -2.79% respectively. There is an increase in negative reaction to merger announcements by acquiring firms in India in post-announcement period. Mishra and Goel (2005) find negative announcement day and overall CAR for RIL, acquiring firm. They document an announcement day CAR of -4.48% and overall CAR of -3.54% for the similar event window. However, Rajesh Kumar and Panneerselvam (2009) find a negative overall CAR for acquiring firms involved in acquisitions and a positive CAR for acquiring

firms involved in mergers.

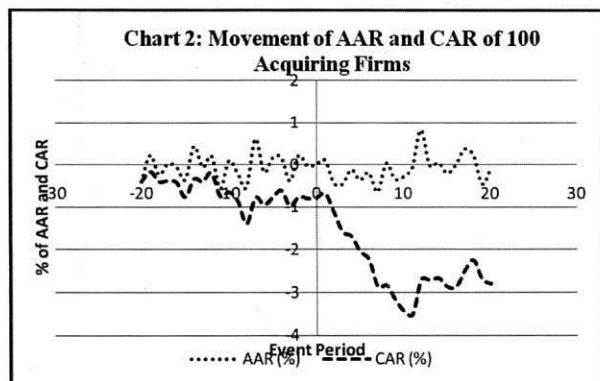
The negative CAR on announcement day shows a continuous rising trend till 11<sup>th</sup> day in post-announcement period. From a high of -3.5% on 11<sup>th</sup> day it decreases to -2.79% by the end of 20<sup>th</sup> day in post-announcement period. Since overall negative CAR is higher than the announcement day negative CAR the long-term investors would lose more on account of merger announcements in India than short-term investors. An investor who sells on the announcement day is better off in India than the one who holds the shares of acquiring firms on long-term basis. The latter investor would lose almost 51%, on annualized basis, for 20-day period.

Dutta and Jog (2009) find similarly for Canadian mergers. The study finds positive announcement day AAR and CAR. The announcement day CAR for 989 merger cases was 0.8% and 3-day CAR was 1.3%. However, the market subsequently corrects for its initial positive reaction to news of the acquisition. There are significant negative abnormal returns on day +6 (-0.27%) and day +10 (-0.28%). Further, CAR values become insignificant in 15 days after the announcement date. Moeller et al. (2005) find that from 1991 to 2001 (the 1990s), acquiring firms' shareholders lost an aggregate of \$216 billion, or more than 50 times the \$4 billion they lost from 1980 to 1990 (the 1980s). They show that a large part of this loss has occurred from 1998 to 2001 wiping out all the gains made earlier. They ascribe this loss to the announcement of large deals in the latter part of the 1990s. The large loss deals accounted for 43.4% of the money spent on acquisitions from 1998 to 2001. Large loss deals have a negative average abnormal return of -10.6%. Moeller et al. (2004) find a positive CAR of 1.10% for 3-day window, but CARs differed between large and small firms. The large firms, announcing large deals, recorded a 3-day CAR of 0.076% compared to 2.318% by small firms announcing small deals.

As far as the distribution of number of companies with positive AAR on the announcement day, the study finds that the returns are not widely distributed. There are only 53% of the acquiring firms generating positive returns on the announcement. For days

prior to and subsequent to the announcement day, this percentage is higher.

Chart 2 presents the pictorial depiction of the movement of AAR and CAR for 100 acquiring firms in India.



#### 4.2. Movement of AAR and CAR in various sub-periods

The movement of AAR and CAR in 41-day event window is further analysed by its analysis over various sub-periods. The study considers -20 to -11, -10 to -1, -1 to +1, +1 to +10, +11 to +20, +1 to +20, and other sub-periods. The data relating to these periods is presented in Table 3.

**Table 3: Movement of AAR and CAR in sub-periods**

Days	AAR (%)	t-test	CAR (%)	p-value
-20 to -11	-0.56	-6.61*	-0.75	0.0001
-10 to -1	-0.03	-1.50	-0.05	0.1689
-1 to +1	0.11	0.20	0.08	0.8598
+1 to +10	-0.27	-4.78*	-2.64	0.0010
+11 to +20	-0.10	6.67*	0.64	0.0001
+1 to +20	-0.10	-10.23*	-1.10	0.0001
-7 to +7	-0.64	0.82	-1.48	0.4268
-5 to +5	-0.36	-0.89	-1.10	0.3936
-3 to +3	-0.46	-2.99*	-0.97	0.0306

\* indicates significance at 1% level

The movement of AAR and CAR in all sub-periods of 41-day window has been negative except in -1 to +1 sub-period. The positive returns in -1 to +1 sub-period are not only negligible but are transient. An increase in the sub-period to -3 to +3 or -5 to +5 makes returns negative. This again indicates that short-term investors can make some money out of sale of shares of acquiring firms than long-term investors.

#### 4.3. AAR and CAR for 3-day event period

Gregor et al. (2001) opine that the most statistically reliable evidence on whether mergers create value for shareholders comes from traditional short-window event studies, where the average abnormal stock market reaction at merger announcement is used as a gauge of value creation or destruction. They consider three days immediately surrounding the merger announcements, that is, from one day before to one day after the announcement as one of the two popular event windows. In view of this importance of 3-day event window, the study computes the 3-day window period based AAR and CAR. Table 4 presents the data relating to these aspects.

**Table 4: AAR and CAR for 3-day window**

Window Period	AAR (%)	t-test	CAR (%)	% of Co with +ve AAR
-1	-0.004	-0.135	-0.004	46
0	<b>-0.040</b>	<b>1.465</b>	<b>-0.045</b>	<b>50</b>
1	0.129	0.705	0.084	50
Avg	0.028	0.679	0.012	
Std dev	0.089	0.801	0.066	
Sqrt	0.052	0.462	0.038	
t-test	0.546	1.468	0.310	

The investor suffers an average insignificant loss of 0.04% on the announcement day even in 3-day event period. This again proves that acquirers have no gains around the announcement date, but there is no evidence of significant losses (Franks et al. 1991). The returns become positive on +1 day. As a result, the overall CAR is positive and is 0.08%. The CAR for 41-day window is -2.79% compared to a positive CAR of 0.08% in the 3-day window. Since market reacts negatively in the post-merger announcement period, the investor would be better off to sink his investment immediately than to hold it.

#### 4.4. Announcement returns for both acquiring and target firms

In previous pages the returns were computed from the point of 100 acquiring firms' shareholders. Do mergers benefit target firms' shareholders? We examine this question in the following pages. In view of lack of price data,

the study restricts the target firms sample size to only 33. These firms are compared with their 33 acquirers in computing abnormal returns. Table 5 presents information relating to AAR and CAR of 33 acquiring firms.

**Table 5 : AAR and CAR of 33 Acquiring Firms**

Window Period	AAR (%)	t-test	CAR (%)	% of Co with +ve AAR
-20	-0.89	-1.16	-0.89	39
-19	-0.25	-0.15	-1.14	58
-18	0.01	0.18	-1.13	42
-17	-0.48	-0.36	-1.61	39
-16	-0.05	0.38	-1.66	45
-15	0.14	0.48	-1.51	48
-14	0.43	0.76	-1.08	48
-13	-0.12	0.07	-1.20	42
-12	-0.46	-0.58	-1.66	39
-11	-0.66	-0.90	-2.32	30
-10	-0.19	0.34	-2.51	42
-9	-0.90	-0.95	-3.41	39
-8	-0.46	-0.14	-3.87	51
-7	-0.11	0.60	-3.98	45
-6	-0.88	-2.08**	-4.86	39
-5	-1.11	-2.20**	-5.97	27
-4	-0.03	0.10	-5.99	48
-3	-0.53	-1.15	-6.53	42
-2	0.65	1.57	-5.88	51
-1	-0.44	-0.44	-6.32	36
0	<b>1.31</b>	<b>2.41**</b>	<b>-5.01</b>	<b>52</b>
1	-0.43	0.06	-5.44	39
2	-0.43	-0.50	-5.87	36
3	-1.21	-2.21**	-7.08	33
4	-0.66	-1.09	-7.74	42
5	-0.81	-1.76***	-8.54	24
6	-0.99	-1.69***	-9.53	24
7	-0.43	-0.38	-9.96	39
8	-0.02	-0.10	-9.99	33
9	-0.72	-1.14	-10.71	30
10	-0.32	-0.36	-11.02	39
11	-0.76	-1.50	-11.78	27
12	-0.19	-0.81	-11.97	42
13	-0.35	-1.16	-12.32	30
14	0.12	0.72	-12.20	51
15	-0.41	-0.92	-12.62	42
16	-0.10	-0.00	-12.72	54
17	0.21	0.70	-12.50	45
18	-0.08	-0.09	-12.58	39
19	-0.08	-0.18	-12.67	48
20	-0.08	-0.35	-12.75	42
Avg	-0.31	-0.39	-6.79	
Std dev	0.48	0.97	4.27	
Sqrt	0.08	0.17	0.74	
t-test	-3.69	-2.30**	-9.13	

\*, \*\* and \*\*\* indicate significance at 1%, 5% and 10% levels respectively

The announcement day return has been positive and statistically significant at 1.31%. However, both the announcement day CAR and the overall CAR are negative. CAR increases from -5.01% on the announcement day to -12.75% by the end of the window period. Further, the CAR is negative in almost all the days of 41-day window period indicating the market's negative reaction to the merger decisions.

Table 6 provides information relating to AAR and CAR of 33 target firms for 41-day window period. The target firm shareholders earn a significant announcement day return of 2.18% in India. However, this euphoria is not sustained on long-term basis. The announcement day and the overall CARs are negative. In fact, the negative CAR of 1.31% on the announcement day increases to -10.39% by the end of the window period. Further, the positive announcement day returns are also not fairly distributed across all target firms. There are only 58% target firms with positive announcement returns. Since there are negative returns over the period, it can be said here that the short-term investors would suffer lower loss than the long-term investors. The study has made a similar conclusion for shareholders of acquiring firms. Thus, in general, merger announcements do not improve the wealth of shareholders in India over a longer window.

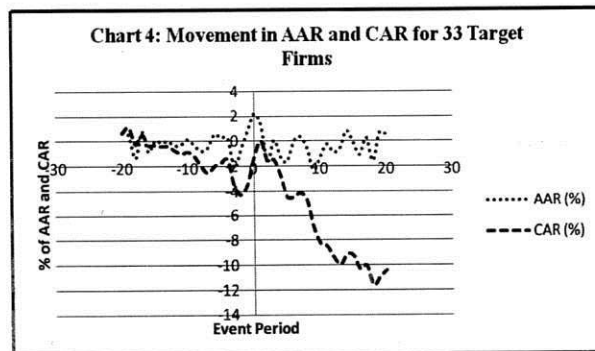
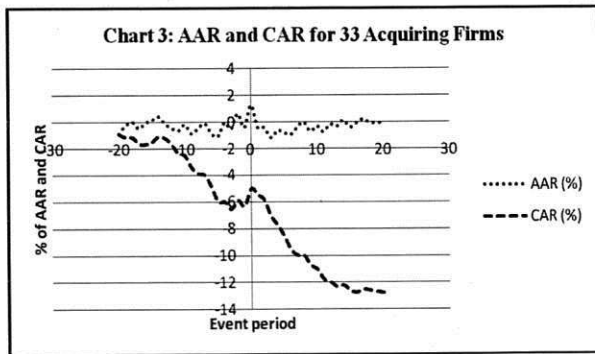
**Table 6: AAR and CAR for 33 target firms**

Window Days	AAR (%)	t-test	CAR (%)	% of Co with +ve AAR
-20	0.65	0.50	0.65	48
-19	0.47	0.87	1.12	52
-18	-1.35	-1.81***	-0.23	33
-17	0.76	0.92	0.53	52
-16	-0.85	-0.54	-0.32	36
-15	0.05	0.62	-0.28	48
-14	-0.12	-0.16	-0.40	39
-13	0.01	0.70	-0.39	45
-12	-0.35	-0.07	-0.74	55
-11	-0.25	-0.34	-1.00	52
-10	0.13	0.03	-0.86	52
-9	-0.35	0.26	-1.22	48
-8	-0.79	-0.10	-2.00	36
-7	-0.53	-0.28	-2.53	39
-6	0.54	1.18	-1.99	45
-5	0.27	1.12	-1.72	52
-4	0.26	1.27	-1.46	58

-3	-2.12	-1.87***	-3.58	33
-2	-0.67	-0.95	-4.25	39
-1	0.77	0.88	-3.47	45
0	2.18	5.24*	-1.31	58
1	1.34	0.82	0.04	58
2	-1.61	-3.02*	-1.57	39
3	0.08	-1.41	-1.49	42
4	-1.26	-1.23	-2.75	45
5	-1.64	-1.44	-4.39	33
6	-0.05	-0.037	-4.44	45
7	0.35	0.43	-4.10	55
8	-0.52	-0.52	-4.62	58
9	-2.28	-2.03**	-6.90	36
10	-1.31	-1.53	-8.21	33
11	-0.24	-1.02	-8.45	58
12	-0.88	-0.99	-9.33	55
13	-0.61	-0.92	-9.94	39
14	0.82	1.87***	-9.11	67
15	-0.074	-0.72	-9.19	39
16	-1.09	-1.56	-10.28	30
17	0.28	0.05	-10.00	55
18	-1.58	-1.80***	-11.58	24
19	0.66	1.14	-10.92	58
20	0.54	0.32	-10.39	45
Avg	-0.25	-0.15	-3.98	
Std dev	0.94	1.40	3.93	
Sqrt	0.15	0.22	0.61	
t-test	-1.72	-0.68	-6.48	

\*, \*\* and \*\*\* indicate significance at 1%, 5% and 10% levels respectively

Charts 3 and 4 depict the pictorial movement of AAR and CAR for both acquiring and target firms.



#### 4.5. Movement of returns in various sub-periods for acquiring and target firms

A further attempt is made to decipher the movement of AAR and CAR of 33 acquiring and target firms by classification of returns into various sub-periods. Table 7 presents the returns by several sub-periods:

**Table 7: AAR and CAR for sub-periods for acquiring and target firms**

Sub-periods	Acquiring Firms			Target Firms		
	AAR (%)	t-test	CAR (%)	AAR (%)	t-test	CAR (%)
-20 to -11	0.56	-6.61*	-0.75	-0.25	-0.50	-0.99
-10 to -1	-0.03	-1.50	-0.05	-0.77	-3.71*	-2.50
-1 to +1	0.12	0.20	0.08	1.34	2.60*	4.29
+1 to +10	-0.27	-4.78*	-2.64	-1.31	-3.20*	-6.90
-11 to +20	-0.10	6.67*	0.64	0.54	-5.80*	-2.18
-7 to +7	-0.64	0.82	-1.48	0.54	-6.89*	-9.08
-5 to +5	-0.36	-0.89	-1.90	-1.64%	-1.68***	-2.40

\* and \*\*\* indicates significance at 1% and 10% levels respectively

Barring -1 to +1 sub-period, for all other sub-periods in both the pre and the post announcement periods and for both the acquiring and the target firms there are negative returns. The negative returns are higher in longer sub-period than in shorter sub-period which again proves that short-term investor would lose less than the long-term investor in firms involved in mergers in India.

Sudarsanam et al. (1986) find 13.96% positive returns for target shareholders and a negative return of 1.26% for bidder shareholders, both significant at the 1% level for the UK. In the post-announcement period day +1 to +40, targets receive a 5.58% CAR (significant at 1%) whereas bidders suffer a negative CAR of 3.56% (significant at 1%). Over -20 to -1, CAR to targets is 9.98% (significant at 1%) and to bidders 0.55% (not significant). In conclusion, the study finds negative returns for bidders in the UK but positive returns for the target firms. The bidders suffer both in the pre and the post-announcement periods. Cheung and Shum (1993) find for Hong Kong target firms positive AAR and CAR on the announcement day. The announcement day AAR is 5.51% while the CAR on the announcement day is 15.21%. However, the overall CAR in the 30-day post-announcement period for target firms decreases by 9.59%. The AAR and CAR both on the announcement day and overall were negative

for the bidding firms. The announcement of merger brings a negative reaction of 0.21% for bidders while the overall CAR was -16.1%. In India, though announcement day CAR is positive for target firms, the overall CAR is negative for both the bidding and the target firms.

#### 4.6. Returns for 3-day window for Acquiring and Target Firms

Since the short-term event window is one of the popular methods of appraising excess returns, the study computes these returns for both the firms involved in mergers. Table 8 shows the details.

**Table 8 : AAR and CAR for 3-day window for Acquiring and Target Firms**

Event days	Acquiring Firms				Target Firms			
	AAR (%)	t-test	CAR (%)	% of Cos with + AAR	AAR (%)	t-test	CAR (%)	% of Cos with + AAR
-1	-0.45	-0.33	-0.45	33	0.67	0.75	0.67	49
0	1.38	2.48**	0.93	54	2.65	5.68*	3.32	58
+1	-0.30	0.09	0.64	42	1.06	0.59	4.38	58
Avg	0.21	0.75	0.37		1.47	2.34**	2.79	
Std Dev	1.02	1.52	0.73		1.05	2.90*	1.91	
Sqrt	0.59	0.88	0.42		0.60	1.67***	1.10	
t-test			0.89				2.53**	

\*, \*\* and \*\*\* indicates significance at 1%, 5% and 10% levels respectively

The AAR is positive on the announcement day for both the acquirers and targets. However, AAR becomes negative on +1 day for acquirers and remains positive for the target firms. The overall 3-day CAR for target firms is 4.38%, much higher than the 0.64% recorded for acquiring firms' shareholders. This is a testimony to the empirical evidence available in the US and the UK that target firms' shareholders reap a larger part of the benefits of mergers than the acquiring firms' shareholders.

Firth (1980), Dodd (1980), Eckbo (1983), Malatesta (1983) and Ruback (1983), etc., document a significant and positive wealth effect for the shareholders of the target firms. On the other hand, Dodd (1980), Firth (1980), Franks and Harris (1989), etc., report short-term negative returns for the acquiring firms' shareholders. Dodd and Ruback (1977), Asquith (1983), Eckbo (1983) and Dennis and McConnell (1986) indicate small but positive abnormal returns to the acquiring firms' shareholders.

#### 5. Conclusions

Mergers, in general, do not create any wealth to the shareholders of the acquiring firms. If there are any gains involved in mergers, they are reaped by the shareholders of the target firms. The present study finds similar conclusions for

the Indian merger cases of recent years. The studies find overpayment and managerial hubris as prime reasons for the mergers to fail to generate benefits to the shareholders of the acquirers. Do Indian managers overpay or suffer from hubris hypothesis? This particular question needs to be investigated in detail and forms a further research area in the field of mergers and acquisitions.

If the results for 41-day and 3-day windows are juxtaposed, the returns appear to be negative for both the firms in the longer window while there are positive returns for both in the shorter window. The study finds 0.64% CAR for the 3-day event period while a negative CAR of 12.75% for the 41-day window for the 33 acquirers. For the larger sample of 100 acquiring firms the CAR in the 41-day period is -2.79% while for the 3-day it is 0.84%. This clearly indicates the ephemeral nature of merger returns. The market reacts favourably in the immediate period of announcement of the merger but reverses its valuation as more details are available and analysed over various aspects of the merger deal. The transient nature of the merger returns can create a delicate position for the holders of equity of the firms involved in the mergers. Should the investment be held or sold-off? A sale brings some relief while holding negates the value for the shareholders of both

the firms. What would be the position of the shareholders if the investment is held beyond 41-day, say, 1-year, 2-years, etc? This is a separate issue and needs a detailed analysis. There are very few studies which have analysed on these lines in India.

There are other determinants of bidder firm returns. The present study makes a general analysis of announcement returns without classifying mergers on the basis of the type of mergers, sectors, motives, methods of payment and characteristics of the firms involved in the mergers. The study opines such an analysis is very much necessary to understand the whole phenomenon of the merger returns in India.

Testing Jensen's (1986) free cash flow hypothesis, Lang et al (1991) find that low  $q$  firms with high free cash flows earn negative returns than high  $q$  firms with high free cash flows. Travlos (1987) and Asquith et al (1987) find that bidders' returns decrease with the fraction of the premium to be paid in the bidder's

common stock. In other words, cash mergers perform better than stock-based mergers. The relative size of the firms involved in the mergers also influence the extent of the returns involved in the mergers. Returns are higher for the larger-size bidder than the small-size bidder relative to the size of the target firms. Similarly, firms undertaking related mergers would report positive returns than the firms undertaking unrelated mergers. The empirical evidence reports that the diversification destroys corporate value (Jensen, 1986). An analysis on these lines for Indian mergers is very much required to understand the reasons behind the negative returns reported by the bidding firms.

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