



## MERGERS AND ACQUISITIONS BY EMERGING COUNTRY MULTINATIONAL COMPANIES



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### ABSTRACT

*This paper investigates the mergers and acquisitions by the emerging country multinational companies. Emerging country multinational companies do not have access to big amounts of capital as many developed country multinational companies. These companies can decide to engage in mergers and acquisitions with those of the other emerging country multinational companies in order to increase their profitability and competitiveness. We examine whether or not emerging country multinationals earn high and significant positive abnormal returns as a result of merger and acquisitions and we also investigate whether or not the return patterns of the emerging country multinationals are different than those of the developed country companies.*

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**Keywords:** Mergers and acquisitions, Multinational companies.

### Contribution/ Originality

This study contributes in the existing literature of mergers and acquisitions by providing information of mergers and acquisitions among emerging country multinational companies. The paper investigates returns of both acquirer and target companies after merger and acquisitions.

### 1. INTRODUCTION

Mergers may be motivated by empire building through growth in size, sales and assets (Schipper and Thompson, 1983). Some mergers create efficiency, synergy (Berry, 2000) or give firms access to recent and unique technology. Others make companies gain market share in competitive industries. Levy and Sarnat (1970) report that cost of capital of a conglomerate firm can be reduced after a merger. On the other hand, the following studies Lang and Rene (1994); Berger and Ofek (1995); Maquieira *et al.* (1988) report that no synergies created through diversification or horizontal mergers.

Different researchers examine the merger and acquisition decisions by developed country multinational companies. Others examine acquisitions by single country acquirers. There are not many studies that investigate the emerging country multinational companies' merger and acquisitions as a group. Unlike those of developed country companies, emerging country multinationals do not have access to large pool of capital resources. Mergers and acquisitions require big capital investment and they may increase the risk level of the acquirer companies. We hypothesize that emerging country multinational companies make merger and acquisition decisions more carefully than developed country companies and as a result, the acquirers get positive significant returns.

This paper examines the emerging country multinational companies' merger and acquisition decisions. Their decisions may result in different outcome than those of the developed country multinational companies. We investigate whether or not abnormal returns are created after the acquisitions by the emerging market multinational companies. The paper is organized as follows: Section I shows the previous studies, Section II presents the data and the methodology and finally Section III displays the results.

## 2. PREVIOUS STUDIES

The papers of [Dodd \(1980\)](#); [Dennis and McConnell \(1986\)](#) conclude that the target firms earn positive abnormal returns after mergers and acquisitions. Their results show that returns to target shareholders range from 20-30 % [Dodd and Ruback \(1977\)](#); [Dodd \(1980\)](#); [Jensen and Ruback \(1983\)](#); [Malatesta \(1983\)](#). However, shareholders of acquiring companies experience either significantly negative [Dodd \(1980\)](#); [Firth \(1980\)](#) and [Eger \(1983\)](#) or non-significantly positive [Eckbo \(1983\)](#); [Dennis and McConnell \(1986\)](#) and [Amihud et al. \(1986\)](#) returns.

[Doukas and Travlos \(1988\)](#) paper investigates the impact of international mergers and acquisitions of U.S. companies. They show that when a U.S. company acquires a company in another country, significant and positive returns are gained. These abnormal returns are larger when firms expand into new industry and geographic markets – especially with those countries that are less developed than the U.S. economy. Further research of [Manzon et al. \(1994\)](#) find that the abnormal returns to U.S. companies making international acquisitions are related to tax differences in the international tax status of acquiring firms. On the other hand, when foreign companies acquire or merge with U.S. companies, both acquiring and target company shareholders earn significant and positive returns ([Eun et al., 1996](#)). Shareholders of the U.S. target companies earn significant wealth gains regardless of the nationality of foreign acquirers. In particular, their study shows that Japanese acquisitions generate the largest wealth gains to both target and acquiring company shareholders. A compelling motivation for foreign managers was gaining the U.S. target firms R&D capabilities and access to a more lucrative US market.

[Rhodes-Kropf and Robinson \(2008\)](#) investigate the role of mergers and acquisitions within the property rights theory of the firm and conclude that high market-to-book acquirers generally buy high market-to-book companies. Their results with 3,400 mergers among publically traded U.S. companies show that like-buys-like explanation fits for these companies.

[Officer \(2004\)](#) examines the motivation for including a collar in a merger agreement, and determines that a collar in a merger bid significantly reduces the probability that the bid price requires renegotiation prior to resolution and therefore bidders and targets choose collar to make sure that the terms of the offer are less likely to require renegotiation.

[Hackbarth and Morellec \(2008\)](#) use a real options framework and a data of 1,086 takeovers in the United States to investigate stock returns in mergers and acquisitions. They find the similar pattern for target and acquirer firm abnormal and cumulative returns. Their main contribution is in discovery of that beta does not exhibit any significant increase or decrease prior to the takeover and drops moderately after the merger and takeover. However after a split of data into subsamples in which acquiring firms' betas are higher or lower than their targets, they observe that beta first increases then decreases after the announcement for the sample in which acquirers' betas are higher and the opposite for the other sample consistent with their model.

The behaviors of professional investors around mergers are examined by [Mitchell. et al. \(2004\)](#). Their results show the existence of price pressure around mergers caused by uninformed shifts in excess demand. They show that in fixed-exchange-ratio stock mergers, merger arbitrageurs short-sell the acquirers' stocks after the announcement and maintain short position until mergers close, causing negative reaction to acquirers stock prices and returns. They conclude that mergers do not destroy value.

The legal effects of mergers and acquisitions are investigated by [Ciobanu \(2015\)](#) in the period of 2006- 2010 to find that the legal environment can enhance financial results of firms by protecting capital and creating a favorable environment for development and capital gains. On the other hand the effects of mergers and acquisitions on marketing performance is analyzed by [Rahman and Lambkin \(2015\)](#) to discover improvement of marketing performance along with sales dimensions and sales revenue. Their research, however, suggests that these results did not improve returns on sales.

[Lipson and Mortal \(2007\)](#) examine changes in liquidity and firm characteristics in order to identify the factors that affect liquidity around M&A deals in the US. Their study suggests that first of all there is a reduction in spreads that can be explained by firm characteristics and also diversifying and non-diversifying mergers do not impact liquidity differently. [Meyer \(2008\)](#) finds that the failure of M&A deals in benefiting the shareholders is attributable to internal forces in the firm. She discovers that shareholder value suffers from two main sources in post merger period. First, the internal stakeholders in the firm tries to drive the value toward themselves and second reduction and reallocation efforts also increase costs.

The following studies investigated the effects of mergers and acquisitions in specific sectors. [Becker-Blease et al. \(2008\)](#) examine the effect of merger and acquisition on electric utility companies after deregulation of power industry in 1991 on shareholders' wealth, and fail to find any evidence that shows the M&A deals done after deregulation have enhanced profits for diversified shareholders. [Rheame and Harjeet \(2008\)](#) assess the financial impact of M&A deals on various firms in information technology sectors. They discover that most acquiring firms that target a firm within the same sectors will experience an increase in shareholders wealth after the acquisition. The acquiring firms that pursue a diversification strategy by targeting a firm from a different sector will not gain a significant positive wealth change. [Khanal et al. \(2014\)](#) assessed impact of M&A deals on share price of public biofuel companies during the period of 2010 and 2012 in the US to find that that the stock price increased due to M&A activities.

[Schiereck et al. \(2009\)](#) analyze correlation between reputation of investment banks as advisors and shareholders wealth in merger and acquisition cases and find that the reputation of advisors in M&A cases do not have any significant effect on profitability of the deal for shareholders.

There are relatively few studies about the non-U.S. firm merger and acquisitions. [Yüce and Ng \(2005\)](#) examine private and public Canadian mergers and find out that both the target and the acquiring company shareholders earn significant positive abnormal returns for two-day holding period starting with the announcement day. They conclude that acquirers that buy private firms earn higher returns, but also get higher risk. Their results indicate that there is no difference between buying private and public firms on a risk-adjusted return basis.

[Huizinga and Voget \(2009\)](#) paper's main focus is cross-border mergers and acquisition between European countries, Japan and the United States. Their research shows that international taxation affects the parent-subsidiary structure of multinational firms created by these mergers. Canada, like the United-States has a worldwide taxation system that requires Canadian firms pay tax on foreign-source incomes.

[Grigorieva and Petrunina \(2015\)](#) examine the impact of M&A deals in emerging capital markets on performance of the firm. Their research is based on comparison of economic profit model and traditional method-accounting studies they discover that the value of combined firms significantly declined in long run. [Rani et al. \(2012\)](#) explore the effect of M&A on share price of acquiring firms between 2003 and 2008 in India. They find that the share prices of acquiring firm increase for 19 days prior to the completion of the merger and they drop for the same period after the completion of acquisition. They also discover that the acquisition financed by cash generate positive abnormal returns whereas acquisition financed by equity do not generate the same positive returns.

Although merger and acquisitions of developed country multinational companies and especially of the U.S. multinationals are studied by researchers, the effects of mergers and acquisitions by emerging country multinational

companies are not investigated properly. There are some individual country level studies, however extensive studies that cover all emerging countries are missing. This study will fill this gap in the literature. We examine effects of mergers and acquisitions on both the target and the acquirer emerging country multinational companies.

In this study we use data on all cross-border mergers concentrating on developing country multinational companies to find out whether these merger and acquisitions create wealth for target and acquirer companies. The next section introduces the data and the methodology that we employ in this paper.

### 3. DATA AND METHODOLOGY

We use the Bloomberg database to construct our cross-border merger and acquisitions (M&A) developing countries sample data. We downloaded the daily information for emerging country M&A deals in the world listed in the database between January 1, 2000 and January 8, 2013. We obtained the developing country acquirer merger and acquisition deals by using the International Monetary Fund (IMF) and (CIA) definitions of developed countries to differentiate which country is developed or developing. In total, our sample is comprised of 38 developed countries and 135 developing countries. The total number of M&A deals is 11,419. We only consider the complete acquisition by the developing country multinationals and after eliminating those deals with incomplete data our data reduced to 1,316 transactions. We further eliminated those deals where the acquirer company did not have at least one year of price data after the acquisition to end up with a data sample of 103 deals.

Our final acquirer data are classified according to their industry and presented at the Appendix. Approximately 8% of our acquirers are commercial banks, followed by gold mining companies and oil and steel producers.

Mergers and acquisitions require large capital expenditures. Generally emerging country multinationals do not have access to large capital resources as developed country multinational do. We hypothesize that emerging country multinationals make careful calculations, before they decide on merger and acquisitions resulting in both the target and the acquirer firms to earn positive abnormal returns. Following Yüce and Ng (2005) we hypothesize that both the acquirer and target companies earn positive significant returns after the announcement. We will test the following hypotheses:

H<sub>1</sub>: Emerging country multinational acquirer companies earn positive significant abnormal returns as a result of merger and acquisitions.

H<sub>2</sub>: Target companies earn positive significant abnormal returns as a result of merger and acquisitions.

We employ the event study methodology to calculate prior and post event day abnormal returns and we also calculate the cumulative abnormal returns of both the target and the acquirer firms. We use the market model to calculate the expected returns on each security. After calculating daily stock returns we regress them against the market index returns to calculate  $\alpha$  and  $\beta$ s of each stock.

$$ER_{it} = \alpha_i + \beta_i R_{mt}$$

where  $R_{it}$  and  $R_{mt}$  represents the return on company  $i$  on day  $t$  and the return on market index on day  $t$ .

The formula for the company daily excess returns and daily abnormal returns and cumulative abnormal returns are as follows:

$$\epsilon_{it} = R_{it} - ER_{it}$$

$$AR_t = \frac{1}{N} \sum_{i=1}^N \epsilon_{it}$$

$AR_t$  is the average abnormal return on day  $t$ . Cumulative excess returns, CAR, over a period of time are formed by summing the average excess returns over the event time.

$$CAR_{1,s} = \sum_{t=1}^s AR_t$$

#### 4. RESULTS

We examine first the daily average abnormal returns of the target companies. Table I displays the daily returns from day -20 to day 20. Target company shareholders generally receive negative returns before the merger. Abnormal returns become positive 4 days before the announcement and reach to 3.73% on the announcement date. However these returns remain statistically insignificant.

Table II displays that the two-day (0,2) cumulative abnormal return is significant at 10% level. The target company shareholders receive positive returns during the first few days around the announcement of the merger and acquisitions by the emerging country multinationals as the previous studies about the developed country multinational company mergers and acquisitions showed. We find that our second hypothesis is proved.

On the other hand when we investigate the abnormal returns for the developing acquirers, we discover that the returns are negative and around zero for most of the days as shown in Table III. On the announcement day the acquirers earn 0.22% positive abnormal return. However it is insignificant.

Table IV shows the cumulative abnormal returns of the acquirers. The two day (0,2) abnormal return is 0.01% and insignificant. All the other cumulative abnormal returns are also negative and insignificant.

We reject our first hypothesis that emerging country multinational acquirer companies earn positive abnormal returns. These results show that unlike our predictions emerging country acquirers do not earn positive significant returns. Unlike Yüce and Ng (2005) the acquirer companies have not earned positive abnormal returns. Multinational acquirers' return pattern is similar to those of the developed country acquirers as was found by the previous studies.

In future, we want to include more data and examine the effects of financial crisis on return pattern of emerging country multinational companies and we will investigate the long-term effects of merger and acquisition decisions by examining the change in profitability and efficiency ratios of the acquirers to find out whether or not these mergers cause profitability and efficiency gains in the long-term.

#### 5. CONCLUSION

We have examined the merger and acquisitions by the emerging country multinational companies between 2000 and 2013. Our results show although the target company shareholders earn positive return, acquirer emerging country multinational companies have not earned positive and significant abnormal returns in the short period.

We will examine the long-term performance of the acquirers and the factors that will affect the M&A decisions of emerging multinational companies in our next paper.

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**Table-1.** Target Companies Abnormal Returns

Event Day	Abnormal Return	t-statistic	Event Day	Abnormal Return	t-statistic
-20	0.07%	0.015	1	1.98%	0.348
-19	-0.01%	-0.002	2	1.34%	0.352
-18	-0.37%	-0.115	3	0.46%	0.123
-17	0.85%	0.182	4	0.82%	0.151
-16	0.08%	0.020	5	1.28%	0.174
-15	0.23%	0.064	6	0.77%	0.151
-14	-0.48%	-0.137	7	0.25%	0.060
-13	0.07%	0.020	8	0.28%	0.080
-12	-0.36%	-0.104	9	0.14%	0.040
-11	-0.09%	-0.029	10	0.40%	0.115
-10	-0.57%	-0.159	11	0.70%	0.162
-9	0.49%	0.081	12	0.08%	0.018
-8	-0.56%	-0.082	13	-1.69%	-0.121
-7	-0.08%	-0.020	14	-0.99%	-0.185
-6	-0.47%	-0.102	15	0.22%	0.038
-5	-0.38%	-0.088	16	0.49%	0.111
-4	0.17%	0.032	17	-0.08%	-0.018
-3	0.68%	0.106	18	0.08%	0.015
-2	0.53%	0.115	19	0.11%	0.018
-1	1.13%	0.142	20	-2.39%	-0.146
0	3.73%	0.387			

**Table-2.** Target Company Cumulative Abnormal Return

CAR Range	Abnormal Return	t statistic
CAR (-5,5)	1.07%	0.9820
CAR (-2,2)	1.74%	1.4218
CAR (0,2)	2.35%	1.8977*
CAR (0,5)	1.60%	1.3778
CAR (0,10)	1.04%	0.9859
CAR (0,20)	0.38%	0.3823
CAR (-10,10)	0.59%	0.6045
CAR (-20,20)	0.22%	0.2293

\*significant at 10% level

Table-3. Acquirer Company Abnormal Returns

Event Day	Abnormal Return	t-statistic	Event Day	Abnormal Return	t-statistic
-20	0.23%	0.076	1	-0.24%	-0.091
-19	0.13%	0.060	2	0.04%	0.016
-18	-0.22%	-0.108	3	0.08%	0.032
-17	0.34%	0.158	4	0.06%	0.022
-16	-0.27%	-0.109	5	-0.59%	-0.254
-15	0.02%	0.009	6	0.32%	0.111
-14	-0.25%	-0.103	7	-0.01%	-0.005
-13	0.18%	0.066	8	0.09%	0.040
-12	0.19%	0.066	9	0.05%	0.018
-11	0.09%	0.043	10	-0.05%	-0.020
-10	-0.46%	-0.167	11	0.60%	0.182
-9	0.44%	0.173	12	0.19%	0.100
-8	-0.38%	-0.187	13	0.06%	0.020
-7	-0.49%	-0.213	14	-0.22%	-0.124
-6	0.02%	0.010	15	-0.14%	-0.049
-5	0.34%	0.099	16	0.29%	0.093
-4	0.02%	0.009	17	-0.27%	-0.095
-3	-0.21%	-0.082	18	-0.01%	-0.003
-2	0.38%	0.124	19	0.62%	0.194
-1	-0.58%	-0.093	20	-0.30%	-0.141
0	0.22%	0.085			

Table-4. Acquirer Company Cumulative Abnormal Return

CAR Range	Abnormal Return	t statistic
CAR (-5,5)	-0.04%	-0.1302
CAR (-2,2)	-0.04%	-0.0223
CAR (0,2)	0.01%	0.0859
CAR (0,5)	-0.07%	-0.2388
CAR (0,10)	0.00%	-0.0112
CAR (0,20)	0.04%	0.1319
CAR (-10,10)	-0.05%	-0.1441
CAR (-20,20)	0.01%	0.0257

## APPENDIX

Sample Statistics of Emerging Public Companies in Acquisitions

		Acquiring Companies	Target Companies
Total Number of Listed Companies		77	80
Average Transaction Value		\$207,839,693.9	\$209,979,072.2
Acquiring Companies Industry	Industry as Percentage (%)		
Commercial Bank	7.79%		
Gold Mining	6.49%		
Oil Comp-Integrated	6.49%		
Steel-Producers	5.19%		
Diversified Operations	3.90%		
Electric-Integrated	3.90%		
Medical-Drugs	3.90%		
Agricultural Operations	2.60%		
Building-Heavy Construct	2.60%		
Building&Construct-Misc	2.60%		
Diversified Minerals	2.60%		
Electric-Generation	2.60%		
			<i>Continue</i>



Finance-Invest Bnkr/Brkr	2.60%		
Finance-Other Services	2.60%		
Real Estate Oper/Development	2.60%		
Telephone-Integrated	2.60%		
Agricultural Chemicals	1.30%		
Airlines	1.30%		
Audio/Video Products	1.30%		
Brewery	1.30%		
<u>Acquiring Companies Industry</u>	<u>Industry Percentage</u>		
Computer Services	1.30%		
Computer Software	1.30%		
Diversified Manufact Op	1.30%		
Electronic Compo-Misc	1.30%		
Energy-Alternate Sources	1.30%		
Finance-Investment Fund	1.30%		
Finance-Leasing Company	1.30%		
Import/Export	1.30%		
Internet Applic Sftwr	1.30%		
Investment Companies	1.30%		
Motion Pictures&Services	1.30%		
Motorcycle/Motor Scooter	1.30%		
Networking Products	1.30%		
Non-Ferrous Metals	1.30%		
Oil Refining&Marketing	1.30%		
Pastoral&Agricultural	1.30%		
Retail-Appliances	1.30%		
Retail-Jewelry	1.30%		
Rubber/Plastic Products	1.30%		
Silver Mining	1.30%		
Telecom Services	1.30%		
Television	1.30%		
Theaters	1.30%		
Whsing&Harbor Trans Serv	1.30%		

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