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Domestic mergers and acquisitions in BRICS countries: Acquirers and targets☆

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ABSTRACT

We study the firm value determinants for domestic acquisitions within BRICS countries considering both acquirer and target shareholders. Targets earn significant positive announcement returns of 1.45% on average. Acquirers lose slightly. We employ a comprehensive set of explanatory variables and test for cross-sectional return drivers. Target returns are negatively related to pre-announcement returns and firm size, while they are positively related to GDP growth. Our results are consistent with insider trading capturing some of the target excess returns, which are highest for small targets based in countries with high recent GPD growth.

1. Introduction

The so-called BRICS countries (i.e. Brazil, Russia, India, China and South Africa) are a highly heterogeneous group, but collectively they account for more than 60% of total deal value in emerging market mergers and acquisitions (M&A) activity (see BCG, 2013). As these markets are mostly growing and former trade obstacles have been reduced, the BRICS economies are a major contributor to the global M&A market.[1] Despite the growing trend for acquisitions to be undertaken by firms from BRICS countries, there are very few academic papers that analyze both parties involved in domestic deals. The majority of the literature on M&As in emerging markets usually focuses on the acquirer and mostly analyzes cross-border deals. Since there is pronounced government participation in businesses within BRICS countries, which may cause differing market reactions as compared to the case of developed markets, it is important for investors to understand the key features of domestic acquisitions.

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[1] They are particularly attractive to strategic acquirers who are familiar with the core business and focus on the generation of synergy effects as well as value creation (see e.g. Canestri, 2014). In the general context of emerging market investors and value creation, Batten et al. (2015) also underline the diversification benefits that can be obtained by investing in commodities.

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In this paper, we seek to close this research gap by analyzing a manually collected sample of domestic M&A transactions from the BRICS countries. The primary purpose of this paper is to determine whether M&A transactions within BRICS countries create value for acquirers and targets. The secondary purpose is to establish the presence of potential return and value creation factors. To this end, we employ the classic event study methodology and calculate abnormal announcement returns. From this event study, we contribute in two ways to the emerging markets literature. First, we conduct a comprehensive analysis of value creation based on cumulative abnormal returns (CAR) yielded by domestic M&A transactions in BRICS countries. Second, we examine the drivers of the 3-day cross-sectional CAR around the acquisition announcement.

Our analysis covers a sample consisting of 50 M&A deal announcements by publicly listed acquirers and targets from BRICS countries in the period between June 2006 and December 2015. The sample size is limited as we restrict our analysis to acquisitions for which both the acquirer and the target are publicly listed companies based in a BRICS country. In addition, we only consider domestic acquisitions. Although the sample size is hence smaller than that of comparable studies, it is statistically sufficient given that we employ daily return observations.[2] We find that the average abnormal return (AR) for the target companies is highly significant at the announcement day, whereas for the acquirers we cannot reject the null hypothesis of zero AR. More specifically, target shareholders experience a positive market reaction, on average, of 1.45%. In contrast to this, acquirer shareholders lose, on average, 0.12% on the announcement day. Our results for the acquirer do not support the results of previous studies that have examined cross-border deals with emerging market acquirers and that report value creation for acquirer shareholders (see e.g. Bhagat et al., 2011 and Aybar and Thanakijsombat, 2015). However, they are in line with the findings of the developed markets literature (see e.g. Yaghoubi et al., 2016a).

In order to explore the factors that influence the CAR around the acquisition announcement, we use a cross-sectional regression to analyze the determinants of the cross-sectional variation in the CARs. For this purpose, we use a comprehensive set of explanatory variables to control for, among others, country-specific differences in governance systems. This set includes the pre-announcement CAR, the gross domestic product (GDP) growth rate of the country where the firm is based, the firm's debt-to-equity ratio, the logarithm of the firm's market capitalization as a proxy for firm size, and the level of corruption, as provided by the International Country Risk Guide (ICRG), to control for country-specific differences in governance systems. All explanatory variables – except the pre-announcement returns – are measured at the fiscal year-end prior to the acquisition announcement. Our results from the cross-sectional regression analysis reveal that the target's CARs are negatively related to firm size and pre-announcement returns, but are positively related to recent GDP growth. The cross-sectional market reaction of acquirer firms is weakly positively related to the firm's debt-to-equity ratio and again negatively related to pre-announcement returns. In addition, we find for acquirer and target firms no evidence for country-specific variations in announcement CARs resulting from different levels of corruption.

The remainder of the paper is organized as follows. In the next section, we review the literature on previous empirical event studies in the emerging markets and, in particular, in BRICS markets. Section 3 contains the research design. Section 4 describes the sample data and presents the results of our empirical analysis. Section 5 presents our conclusions.

2. Literature review

Although there are numerous studies that analyze mergers and acquisitions into and out of developed economies, a much smaller number of studies focus on M&As in emerging economies, and there are very few studies on domestic acquisitions by firms from emerging countries. Since the number of articles and papers focusing on acquisitions in BRICS countries is not nearly as large as that for emerging markets, no restrictions on journals and years of publication are applied in this review.

2.1. Value creation of M&As in emerging economies

Do acquisitions in emerging economies create value? For M&As in emerging markets, the findings on the performance of both parties appear to be mixed. Studies show that returns for acquirers from emerging markets can be either positive or negative. Given the limited number of studies, no consistent pattern can be identified. Previous academic studies on M&As have for a long time appraised the wealth effects of cross-border and domestic M&A transactions by considering the acquiring companies' share price reactions. Some studies argue that domestic M&A activity yields normal returns (see Asquith et al., 1983), that is, returns that are in line with general abnormal announcement returns around the announcement date, while others find that it results in value destruction (see Jensen and Ruback, 1983). Quite contrary results are found for cross-border deals. While theoretically acquisitions can generally be expected to yield benefits, particularly synergies from economies of scale and scope, the unique nature of cross-border deals makes it possible for various market imperfections to be exploited (see Kohli and Mann, 2012). It is still difficult to draw general conclusions, as the academic literature on cross-border M&A deals is split into two opposing groups: research that argues that value is indeed created by these transactions (see e.g. Boateng et al., 2008; Gubbi et al., 2010; and Bhagat et al., 2011), and research that argues against this assumption (see e.g. Datta and Puia, 1995; Eun et al., 1996; Danbolt, 2004; Aybar and Ficici, 2009; and Malhotra et al., 2011). Aybar and Ficici (2009), for example, examine CARs

[2] MacKinlay (1997) shows that the power of an event study depends not only on the number of observations but also on the data frequency. The higher the data frequency, the higher is the inference. For example, using 50 observations sampled at a daily frequency yields a test power of 94%, which is a satisfactory level. However, using 50 observations sampled at a monthly frequency would result in a test power of only 12%.