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Comparing global airline merger experiences from a financial valuation perspective: an empirical study of recent european based airline mergers

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Abstract

During the past decade, the European airline industry has started a series of consolidations. Although the topics of airlines' mergers and acquisitions have been discussed in several aspects, the issue of how their stock prices and trading volumes respond to merger announcements has not been well documented. This paper intends to fill this gap by examining how investors reacted to merger announcements. Empirical results indicate that the dependencies between stock returns and trading volumes were positive and investors were in favor of the firms who made the announcements.

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1 Introduction

Since the financial crisis in 2008, the airline industry in the United States underwent a series of consolidations including the merger of Delta Air Lines and Northwest Airlines in 2008, the merger of United Airlines and Continental Airlines in 2010, the merger of Southwest Airlines and Air Train Airways in 2011, and the merger of American Airlines and US Airways in 2013.

During a similar time frame as in the United States, significant consolidation, through airline mergers occurred in Europe, as well, changing the competitive landscape of the continent. Mergers involve a significant volume of company share transactions. In theory, eager arbitrageurs would be active in trading shares at the merger announcement period in an effort to profit from price inefficiencies in the market by making simultaneous trades that offset each other and capturing risk-free profits.

However, in practice, whether airlines mergers would experience the above-described situation is unclear and merits our investigation as airline mergers are economically important and involve billions of dollars in terms of transactions and value. This study focuses on the merger cases of Iberia-British Airways, Air France–KLM and Lufthansa (Swiss, Brussels, and Austrian), the largest aviation groups in Europe in terms of traffic, size, and capitalization.

International Consolidated Airlines Group, S.A. (IAG) is a British-Spanish multinational airline holding company, formed in January 2011 by the merger of British Airways (UK) and Iberia (Spain). British Airways and Iberia signed a preliminary merger agreement in November 2009. In April 2010, British Airways and Iberia signed a full merger agreement, with an intended completion date of late 2010, subject to securing the necessary regulatory approvals. The merger between British Airways and Iberia was completed on 21 January 2011, and shares in IAG began trading in the London and Madrid stock exchanges on 24 January of the same year.

Lufthansa (sometimes also listed as *Lufthansa German Airlines and Deutsche Lufthansa AG*), is the flag carrier of Germany and also the largest airline in Europe, both in terms of overall passengers carried and fleet size when combined with its subsidiaries. Besides the actual airline named Lufthansa, Deutsche Lufthansa AG is also the parent company for several other airlines, including Swiss International Air Lines, Austrian Airlines, and Germanwings. On March 22, 2005, Swiss International Air Lines was purchased by Lufthansa's holding company. The acquisition included the provision that the majority of shareholders (the Swiss government and large Swiss companies) be offered payment if Lufthansa's share price outperforms an airline index during the years following the merger. The two companies have continued to run separately. On September 15, 2008, Lufthansa Group announced its purchase of a stake in Brussels Airlines. In June 2009, the EU Commission granted regulatory approval for this strategic partnership between Brussels Airlines and Lufthansa. The decision paved the way for Lufthansa to acquire an initial 45% stake in SN Airholding SA/NV, the parent company of Brussels Airlines. Lufthansa has an option to purchase the remaining 55% of Brussels Airlines until 2017. In September 2009, Lufthansa purchased Austrian Airlines.

Air France–KLM is the result of the merger in 2004 between Air France and KLM. In October 2005, Air France Cargo and KLM Cargo, the two freight subsidiaries of the group, merged their commercial activities. The Joint Cargo Management Team now operates the organization worldwide from the Netherlands.

Mergers are common practice in business. The key concept of a merger is that a company can extend its business and create shareholders' value by purchasing another company. Generally, mergers can be classified into two basic types: focusing and diversifying. Focusing mergers can be explained as "buy your competitors". This type of merger happens when a company purchases another company who has similar market focus and operation structure. Therefore, by purchasing its competitor, the existing company is hoping to enhance its market shares and create shareholders value.

The mergers of Lufthansa and Swiss–Austrian, may belong to this type, as the airlines had many overlapping areas before the mergers, and both existing companies get more market shares on their routes after the mergers. The second type is diversifying, meaning the company can expand its service by purchasing another company who focuses on a different market.

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