Impact of Mode of Payment and Insider Ownership on Target and Acquirer’s Announcement Returns in India

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This paper examines the effect of mode of financing employed in mergers and acquisitions on the announcement period returns of the acquiring and the target companies’ shareholders in India. The study is divided into two sections.

• The first section analyses the announcement returns of both the acquiring as well as the target companies’ shareholders with the help of market model. It has been found that maximum value has been created for the shareholders of the target companies engaged in cash offers followed by the shareholders of acquiring companies engaged in cash offers, target companies engaged in stock offers, and lastly, for acquiring companies engaged in stock offers. However, in contrast to the results of prior research, the study shows that the within-group stock offers have created positive wealth for acquiring companies’ shareholders that have generally lost value in stock offers.

• To discern the probable reasons for the positive value being created in within-group stock offers especially for the acquiring companies’ shareholders, the second section analyses the interaction between the announcement returns of the acquiring and the target companies engaged in stock offers and insiders’/promoters’ ownership level. This is so because the review of literature highlights two views regarding value creation in within-group stock offers. One view relates to the tunnelling effect whereas the other relates to the value added effect.

• The tunnelling effect states that within group acquisitions by the acquiring companies with controlling shareholders are aimed at shifting the resources from one group company where the acquiring company has lower cash flow rights to another group company where it has higher cash flow rights or to itself for maximizing the benefits of the controlling shareholders at the expense of minority shareholders.

• The value added view states that within-group acquisitions by the acquiring companies with controlling shareholders are aimed at creating various financial and economic synergies by pooling the resources of both the companies in the post-acquisition period.

The analysis reveals that the within-group stock offers have created value with increase in level of ownership with maximum value being created when controlling shareholders’ ownership reaches the highest level (the category OWN> 49%). Likewise, not only acquiring companies’ but the target companies’ shareholders have gained positive returns. It means the stock market has reacted positively to the news of stock offers when these are undertaken by companies belonging to the same group as well as when the ownership is concentrated in the hands of promoters. Thus, we deduce that in India, within-group stock offers are not aimed at tunnelling of resources by the acquiring companies; rather these are aimed at creating value by providing an internal market where the group companies can pool their resources and hence can create various kinds of synergies in the post-acquisition period. Hence, the results are in consonance with the value added view. Thus, in the world of information asymmetry, the mode of financing along with ownership structures are the signals through which the stock market assesses the value creating potential of an acquisition.
While making an acquisition, an acquirer may satisfy the target shareholder’s claims by paying cash or by issuing shares or else by a combination of both cash and shares. It has been well documented by researchers, internationally, that the stock markets react differentially to the stocks of the acquiring and the target companies on the basis of the mode of payment employed for financing these transactions. Target companies’ shareholders have experienced larger returns when acquisitions are financed with cash rather than with exchange of the acquiring companies’ shares (Kummer and Hoffmeister, 1978; Wansley, Lane and Yang, 1983; Huang and Walkling, 1987; Davidson and Chung, 1997; Carleton et al., 1983). As regard the acquiring companies’ shareholders returns, it has been observed that they earn normal returns on the announcement of cash offers while the returns in stock offers are negative (Brown and Ryngaert, 1991; Smith and Kim, 1994; Loughran and Vijh, 1997; Blackburn, Dark and Hanson, 1997; Faccio and Masulis, 2004). Various hypotheses have been advanced by the researchers to explain the reasons for the differing stock market reaction towards cash as well as stock offers. These hypotheses are as follows:

**Asymmetric Information Hypothesis:** This hypothesis is advanced by Myers and Majluf (1984). It states that in the world of information asymmetry between managers and the market participants, the different modes of payment used in financing an acquisition give differing signals to the market about the value of the company. It states that when an acquirer finances an acquisition with stock, it conveys a negative signal to the market about the overvalued stock of the acquiring company and hence of its bleak long-term prospects. The overvalued stock means shares of the acquiring company are trading at a premium to the book value of its assets because market expects such companies to have huge growth opportunities in future but it is difficult to value these opportunities compared to the assets in place (Martin, 1996). Hence, a stock offer enables an acquirer to share the risk of not realizing the expected future growth opportunities with the target company in the post-acquisition period.

Further on, Hansen (1987) opines that in case of asymmetric information on the part of acquirer, that is, when an acquirer is not able to assess the true value of the assets of the target company, it will finance such an acquisition with stock. The reason being the stock financing has a contingent payment effect and enables the acquirer to share the risk of mis-valuation or overvaluation of the target company with that of the target shareholders in the post-acquisition period. Again, stock offers convey a negative signal to the market that the acquirer is skeptical about the valuation of the target company and wants to share the risk of overvaluation with the target company shareholders in the post-acquisition period. Otherwise, it would have financed such an acquisition with cash and reaped the benefits of potential synergies alone.

Hence, due to the above factors, announcement of the stock offers is accompanied with a negative stock market reaction that in turn leads to negative valuation of the acquiring companies’ shares (Kummer and Hoffmeister, 1978; Huang and Walkling, 1987; Travlos, 1987; Sullivan, Jensen and Hudson, 1994).

Carleton et al (1983), Martin (1996) and Zhang (2003) study different factors that influence an acquirer’s decision regarding mode of payment to be used in financing acquisitions. They also support the above notion that the possibility of stock financing increases with the acquiring company’s shares being overvalued in the market.

On the other hand, a cash acquisition depicts the confidence of an acquirer in correctly assessing the value of a target company and thus reduces the risk of overvaluation and hence of losing the expected synergies. Therefore, stock markets always welcome cash offers considering these as good news. This in turn leads to positive valuation of share prices of both the target and the acquiring companies (Loughran and Vijh, 1997; Emery and Switzer, 1999; Martynova and Renneboog, 2006).

From the above discussion, it can be concluded that in case of asymmetric information, mode of financing employed is the only source used by the stock market to assess the riskiness of an acquisition. Hence, the stock market gives differing reaction to the announcement of acquisitions on the basis of mode of financing being used.

**Relative Size Hypothesis:** The size of the target company relative to that of the acquiring company is also an important factor that affects the decision of the acquirer regarding the mode of payment to be employed in financing an acquisition. Danbolt (2004) argues that the...
acquiring companies prefer paying more premium for small targets, as it is believed that integrating a small target is easier as compared to a larger one. Further, Hansen (1987), Travlos (1987) and Zhang (2003) support the notion that the probability of an acquisition being financed with stock increases with the increase in the relative size of the target company because stock financing helps the acquirer in sharing the risk of realizing synergies with the target in the post-acquisition period.

However, there is a lack of consensus among the researchers on this issue. Martin (1996) does not find any support for the relative size hypothesis and concludes that size is a poor indicator of an acquirer sharing the risk with the target company. Similarly, Ghosh and Ruland (1998) also do not find any support for the size hypothesis.

**Taxation Hypothesis:** Another reason for the acquiring company using different modes of payment in financing an acquisition is the differential tax implications of cash and stock offers for the acquiring and the target company shareholders.

The cash offers generate immediate tax liability for the target company’s shareholders. Hence, in order to offset their additional tax burden in cash offers the target shareholders command a higher acquisition price (more premium).

As regard the acquiring company, cash as a mode of financing is usually employed when the acquiring company is undervalued and generally in cash acquisitions, purchase method of accounting is employed whereby the assets of the target company are revalued according to the current market valuations. This in turn provides a huge depreciation tax shield to the acquirer on the assets of the target company. Moreover, cash acquisitions are generally financed by raising debt and this creates an interest tax shield for the acquirer that in turn increases the probability of higher cash flows in the post-acquisition period (Krishnamurti and Vishwanath, 2008).

Carleton et al. (1983) state that these two effects work in offsetting directions for an acquiring company, one effect reduces the benefits to the extent of price paid to the target company and second makes an acquiring company willing to pay more for the target company to enjoy higher cash flows in the post-acquisition period. Hence, in the process of bargaining, the acquiring company may end up paying more premium than the expected benefits of depreciation and interest tax shield. This is the reason for the acquiring company getting only normal returns while the target company shareholders enjoying substantial returns in cash offers (Wansley, Lane and Yang, 1983; Huang and Walkling, 1987; Brown and Ryngaert, 1991; Davidson and Chung, 1997).

On the other hand, for the target, the common stock offers are generally tax-free acquisitions because capital gains tax for the target shareholders is deferred until the stock is sold in the market. Further, these do not provide the acquirer the interest and depreciation tax shield benefits. Hence, in stock offers the acquiring companies avail negative returns while the target company shareholders enjoy only normal returns.

Thus, tax consideration is also an important factor that affects the decision of the acquiring company regarding the mode of payment to be employed in financing an acquisition.

**Control Hypothesis:** The choice of alternative modes of financing in mergers and acquisitions is also influenced by insiders’/promoters’ ownership in the acquiring company. Insider ownership has been defined in two ways namely managerial ownership and *de facto* ownership (Phani et al., 2005). Managerial ownership means where managers are assigned ownership rights as a *post facto* incentive by the owner whereas *de facto* ownership means the owner who promotes the company also manages it.

Cash financing is preferred in such acquiring companies where insiders hold large percentage of shares, as they do not want to dilute their ownership in the combined company. On the other hand, stock financing is employed by the insiders who have lower ownership stakes in the firm (Amihud, Lev and Travlos, 1990). It means that in companies where insider ownership is high, the probability of insiders pursuing value creating strategies is more as otherwise it will lead to the value destruction of their own shares. Thus, they select those targets where possibility of realizing synergies is more, and finance such acquisitions with cash, than with stock so that they need not share the value created with target companies’ shareholders in the combined company. Hence, cash acquisitions are followed by positive returns.
Stock offers are accompanied with negative returns as such acquisitions are made by the insiders (having lesser ownership) for increasing the size of the firm in order to draw personal benefits (like enhanced compensations based on growth of firm) and not for maximizing wealth of shareholders.

Ghosh and Ruland (1998) study the hypothesis from the perspective of target company’s managers. They find that where large percentage of ownership is with managers, stock financing is preferred as their jobs in the combined company are dependent on their ownership in the combined company.

Hence, according to this hypothesis, cash offers reward shareholders of both acquiring as well as target companies. While the stock offers are generally aimed by the acquiring company’s insiders at drawing personal benefits which in turn yield negative returns to the acquiring company’s shareholders.

The review of the above-stated hypotheses suggests that the method of payment employed to finance an acquisition has an impact on the announcement period returns of both the acquiring and the target company. Stock offers convey various negative signals to the market. Either the acquirer or the target company’s shares/assets are overvalued in the market. Overvaluation in turn signals the risk of realizing the expected synergies in the combined company as the fundamentals of the merged company would not be as strong as they are being projected in the market. Also, stock offers are generally adopted by insiders with lower ownership (Amihud, Lev and Travlos, 1990). Such insiders have complete control over the resources of the company, but they use these to maximize their own benefits by indulging into non-value creating mergers and acquisitions. Thus, stock offers are used as a defence by the acquiring companies to share the risk of failure with the target shareholders in the combined company.

Cash offers on the other hand resolve the valuation problem of the acquirer who believes its shares to be under-valued and also of the target company which is uncertain of the acquirer’s true value (Rappaport and Sirower, 1999). Also, cash financing is employed by the managers in cases where they hold significant shareholding of the acquiring company. Here the interests of managers are aligned with those of the company. Hence, the probability of managers indulging in value destroying mergers is less (Amihud, Lev and Travlos, 1990). Nevertheless, acquirers in cash offers earn normal returns or non-negative returns while target company shareholders get significant positive returns. This can also be attributed to the taxation hypothesis. In conclusion, it can be said that the cash acquisitions highlight the acquirers’ confidence (in a particular acquisition) to the market whereas stock offers signal the inherent weaknesses of both the acquiring and the target companies.

**OBJECTIVE OF THE STUDY**

From the review of various hypotheses, it is clear that the mode of payment employed in financing an acquisition affects the shareholders returns for both the acquiring and the target companies. Though a plethora of research has been carried out in this area internationally, in India, very limited research has been conducted. Though studies have found the impact of mergers and acquisitions on share prices of the acquiring companies (Beena, 2000; Pandey, 2001; Agarwal and Singh 2002), none of these studies have comprehensively analysed the impact of mergers and acquisitions on the shareholders’ wealth of both the acquiring and the target companies. Beena (2000) has studied the stock prices of the acquiring companies whereas Pandey (2001) and Agarwal and Singh (2002) have analysed the target companies’ returns on announcement of mergers and acquisitions. Moreover, none of the study has so far studied the impact of method of payment on shareholders’ wealth for both the acquiring and the target companies though Basanna and Basavaraj (2006) have analysed the impact of means of payment on the capital structure of the acquiring companies. Hence, keeping in view the gap in the existing Indian literature, the objective of this study is to examine the impact of mode of payment used in financing the mergers and acquisitions on the acquiring and the target companies’ shareholders wealth by analysing the announcement period returns because it is the mode of payment employed in the acquisitions that reflects the confidence and commitment of the acquirer towards shareholder value creation or otherwise.

**DATABASE AND SAMPLE SELECTION**

For appraising the effect of method of payment employed in financing an acquisition on the announcement period returns of the acquiring as well as the target companies, mergers and acquisitions announced during 1st
April, 2001 till 31st December, 2008 are considered. Information regarding announcement date, outcome date, and mode of financing mergers and acquisitions is obtained by scanning two leading financial dailies namely, *The Economic Times* and *The Financial Express*, for the above-stated period. Further, to cross-check the announcement and outcome dates of mergers, the official website of Bombay Stock Exchange (BSE) is consulted while for takeovers/tender offers, the official website of Securities Exchange Board of India (SEBI) is consulted. Data regarding daily returns of individual stock of companies has been obtained from PROWESS, the database software developed by the Centre for Monitoring Indian Economy. Only domestic and successful mergers and acquisitions announced during the said period have been considered. A merger is considered successful when both the acquiring and target companies obtain requisite sanction from their concerned high courts and the target company is subsequently de-listed from its respective stock exchange. Takeovers are considered successful in cases where the acquiring companies acquire majority interest (≥50% shares) of target companies’ common equity. Further, we have taken only those takeovers where the aim of the acquirer is to take over the management and control of the target companies by acquiring 50 per cent or more of the outstanding equity shares of the target companies (including the shares acquired via memorandum of understanding and in subsequent tender/open offer).

For an offer to be included in the sample, the following conditions have to be satisfied:

- Both the acquiring and the target companies need to be listed on the BSE for the above-stated period.
- Daily returns of both the acquirer and the target companies need to be available for the estimation period (-250 days to -51 days, zero day being announcement day) and the event period (day -50 to day +50); otherwise the companies are deleted.
- Clustered acquisitions where the acquirer has entered into more than one acquisition within a gap of one year are deleted.
- Further, such acquisitions have been deleted where the mode of payment is ambiguous and it is not possible to categorize these as cash or stock offer.

After applying the above-stated restrictions, we obtained a sample of 69 offers where 39 are cash-financed while 30 are stock-financed offers. The category stock offers includes the transactions where payment is made solely in common stock, that is, by swapping the shares of acquiring companies with that of the target companies. Following Dewenter (1995), those cases have been included in stock offers where part payment is in cash and part payment is with stock (mixed financing).

Similarly, following Martin (1996), the cases where the mode of payment is pure cash or cash plus assumption of target companies’ liabilities, are considered as cash offers. Further, in order to make sure whether a particular transaction is a stock or a cash offer, the source from where the funds have been generated to finance these transactions is considered. If the acquisition is financed from internal accruals or by raising debt, it is categorized as cash offer while those financed by swapping the shares of the acquiring companies with the target companies’ shares are considered as stock offers. The yearly distribution of mergers and acquisitions segregated according to mode of payment employed is detailed in Table 1.

From the table, it is clear that stock is used as a mode of payment for financing mergers while cash financing is used for financing acquisitions or tender offers. Also, stock has been used for financing within-group mergers while either stock or cash has been employed to finance non-group offers.

**METHODOLOGY**

Event study measures the impact of any unanticipated event on the wealth of a company’s shareholders by analysing the abnormal returns around that event period (Brown and Warner, 1980 and 1985). To examine the market reaction to the announcement of cash and stock offers, risk and market adjusted variant of standard event study methodology as propounded by Fama and Macbeth (1973) and Fama (1976) and which is better known as the market model, has been employed. Firstly, an estimation period is selected for computing the parameters ($\alpha$ and $\beta$) of the market model. The estimation period used here is $t = -200$ to $t = -51$, relative to the first public announcement date of an acquisition ($t = 0$). Daily abnormal return on a particular day $t$ is the excess of the actual return on day $t$ over the expected return.
return on that day. The expected return for a particular day $t$ is computed as follows:

$$\hat{R}_t = \alpha_i + \beta_i R_{mt} + \epsilon_{it}$$

where $\alpha_i$ presents the normal return of the security $i$ when $R_{mt}$ is zero, $\beta_i$ measures the risk of the security $i$ that is, the sensitivity of $R_{it}$ to the market wide factors. $R_{mt}$ is the return on market index (BSE Sensex in this case). So, $\beta_i R_{mt}$ collectively captures the effect of variables that affect the return on all securities or at least most securities while $\epsilon_{it}$ captures the effect of variables more specific to the prospects of a security $i$.

The abnormal return (AR) for a security $i$ on day $t$ is calculated as follows:

$$AR_{it} = R_{it} - \hat{R}_t$$

where $R_{it}$ is the actual return of a particular company’s security $i$ on day $t$ and $\hat{R}_t$ is the expected return on the same day.

Daily abnormal returns for each company are calculated over an interval $t = -50$ to $t = +50$.

Further, daily abnormal returns (ARs) have been averaged over $N$ companies for each day $t$ and are computed as follows:

$$AAR_t = \frac{\sum AR_{it}}{N}$$

Where, $AAR_t$ is the average abnormal daily return on day $t$ and $N$ is the number of companies.

Further, cumulative average abnormal returns (CAARs) are derived by summing the $AARs$ over various time intervals. For example, CAARs for a particular time interval $t_1$ to $t_n$ are derived as follows:

$$CAARs = \sum_{t_1}^{t_n} AAR$$

**ANALYSIS AND INTERPRETATION**

The results of event study for the acquiring and the target companies for cash and stock offers have been discussed as follows.

**Acquiring companies’ returns:** The trend of CAARs for the acquiring companies engaged in cash and stock offers over various sub-periods has been detailed in Table 2. Firstly, the announcement returns of the acquiring companies engaged in stock offers have been discussed followed by the discussion of the announcement returns of the acquiring companies engaged in cash offers.

**Announcement returns of the acquiring companies’ engaged in cash offers:** The trend of CAARs for the acquiring companies engaged in cash offers has been detailed in Table 2. It is clear that during the pre-acquisition period, the trend of CAARs has been somewhat random till the day -30 to -21. However, before the 20th day of the announcement, the rising trend of CAARs has started and it has continued in the post-acquisition period also though some randomness is evident in the trend of CAARs in the post-acquisition period. During the pre-acquisition period, the CAARs have increased from 0.21 (0.12) for the day -20 to day -11 to 1.15 (0.66) for the day...
Maximum and statistically significant returns have been earned during the sub-period -4 to +1 (3.45, 2.56) and -1 to +1 (2.12, 2.23). Even in the post-acquisition period, the rising trend has sustained itself till the 5th day after the announcement. Thus, as expected, cash acquisitions have generated statistically significant wealth around the announcement for the acquiring companies’ shareholders. The results are in conformity with those found in the earlier studies conducted internationally (Travlos, 1987; Loughran and Vijh, 1997; Emery and Switzer, 1999; Martynova and Renneboog, 2006).

Table 2: CAARs Measuring the Announcement Effect for the Acquiring Companies Engaged in Cash and Stock Offers

<table>
<thead>
<tr>
<th>Event Periods</th>
<th>CAARs Cash Offers</th>
<th>t Test</th>
<th>CAARs Stock Offers (overall sample)</th>
<th>t Test</th>
<th>CAARs Stock Offers (within group sample)</th>
<th>t Test</th>
<th>CAARs Stock Offers (non-group sample)</th>
<th>t Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>-50 to -41</td>
<td>0.88</td>
<td>0.51</td>
<td>-2.29</td>
<td>-1.23</td>
<td>-3.34</td>
<td>-1.36</td>
<td>-0.92</td>
<td>-0.32</td>
</tr>
<tr>
<td>-40 to -31</td>
<td>0.36</td>
<td>0.21</td>
<td>1.31</td>
<td>0.70</td>
<td>2.29</td>
<td>0.93</td>
<td>0.04</td>
<td>0.01</td>
</tr>
<tr>
<td>-30 to -21</td>
<td>1.47</td>
<td>0.85</td>
<td>-0.18</td>
<td>-0.10</td>
<td>-1.91</td>
<td>-0.77</td>
<td>2.08</td>
<td>0.73</td>
</tr>
<tr>
<td>-20 to -11</td>
<td>0.21</td>
<td>0.12</td>
<td>-0.33</td>
<td>-0.18</td>
<td>0.32</td>
<td>0.13</td>
<td>-1.19</td>
<td>-0.42</td>
</tr>
<tr>
<td>-10 to -1</td>
<td>1.15</td>
<td>0.66</td>
<td>0.18</td>
<td>0.10</td>
<td>0.91</td>
<td>0.37</td>
<td>-0.76</td>
<td>-0.27</td>
</tr>
<tr>
<td>-5 to -1</td>
<td>1.30</td>
<td>1.06</td>
<td>0.96</td>
<td>0.73</td>
<td>1.96</td>
<td>1.12</td>
<td>-0.35</td>
<td>-0.17</td>
</tr>
<tr>
<td>Zero day</td>
<td>0.49</td>
<td>0.89</td>
<td>-0.32</td>
<td>-0.54</td>
<td>0.17</td>
<td>0.22</td>
<td>-0.96</td>
<td>-1.07</td>
</tr>
<tr>
<td>-1 to +1</td>
<td>2.12</td>
<td>2.23***</td>
<td>-0.62</td>
<td>-0.61</td>
<td>-1.18</td>
<td>-0.87</td>
<td>0.10</td>
<td>0.06</td>
</tr>
<tr>
<td>-4 to +1</td>
<td>3.45</td>
<td>2.56**</td>
<td>-0.48</td>
<td>-0.33</td>
<td>-0.34</td>
<td>-0.18</td>
<td>-0.67</td>
<td>-0.30</td>
</tr>
<tr>
<td>-5 to +5</td>
<td>2.70</td>
<td>1.48</td>
<td>-0.68</td>
<td>-0.34</td>
<td>0.87</td>
<td>0.34</td>
<td>-2.70</td>
<td>-0.90</td>
</tr>
<tr>
<td>0 to +5</td>
<td>1.39</td>
<td>1.03</td>
<td>-1.63</td>
<td>-1.13</td>
<td>-1.09</td>
<td>-0.57</td>
<td>-2.35</td>
<td>-1.07</td>
</tr>
<tr>
<td>0 to +10</td>
<td>0.65</td>
<td>0.36</td>
<td>-5.28</td>
<td>-2.70***</td>
<td>-4.94</td>
<td>-1.91*</td>
<td>-5.72</td>
<td>-1.92*</td>
</tr>
<tr>
<td>0 to +20</td>
<td>0.39</td>
<td>0.15</td>
<td>-5.93</td>
<td>-2.19**</td>
<td>-8.93</td>
<td>-2.50**</td>
<td>-1.99</td>
<td>-0.48</td>
</tr>
<tr>
<td>0 to +30</td>
<td>2.78</td>
<td>0.91</td>
<td>-8.32</td>
<td>-2.53**</td>
<td>-10.71</td>
<td>-2.47**</td>
<td>-5.21</td>
<td>-1.04</td>
</tr>
<tr>
<td>0 to +40</td>
<td>2.92</td>
<td>0.83</td>
<td>-11.15</td>
<td>-2.95***</td>
<td>-15.32</td>
<td>-3.07***</td>
<td>-5.69</td>
<td>-0.99</td>
</tr>
<tr>
<td>0 to +50</td>
<td>0.93</td>
<td>0.24</td>
<td>-13.02</td>
<td>-3.09***</td>
<td>-15.55</td>
<td>-2.79***</td>
<td>-9.71</td>
<td>-1.51</td>
</tr>
</tbody>
</table>

^ t-statistics has been computed as $t = \left( \sum_{t=1}^{n} \frac{AAR_t}{\delta_{AAR} * \sqrt{N}} \right)$, where AAR is the average abnormal return of all the securities from day $t_1$ to $t_n$, $\delta_{AAR}$ is the standard deviation of AAR over the estimation period ($t = -200$ to $t = -51$) and N is the number of days over which AAR is cumulated.

* p value < 0.10, ** p value < 0.05 and *** p value < 0.01 respectively.

-10 to day -1 and further to 1.30 (1.06) for the day -5 to day -1. Maximum and statistically significant returns have been earned during the sub-period -4 to +1 (3.45, 2.56) and -1 to +1 (2.12, 2.23). Even in the post-acquisition period, the rising trend has sustained itself till the 5th day after the announcement. Thus, as expected, cash acquisitions have generated statistically significant wealth around the announcement for the acquiring companies’ shareholders. The results are in conformity with those found in the earlier studies conducted internationally (Travlos, 1987; Loughran and Vijh, 1997; Emery and Switzer, 1999; Martynova and Renneboog, 2006).

**Announcement returns of the acquiring companies engaged in stock offers:** Table 2 also depicts the results of market reaction towards the acquiring companies’ shares associated with the announcement of stock offers over different event periods. It is evident from Table 2 that the trend of CAARs has been random during the sub-period -50 to -41 to -20 to -11. However, from the 10th day before the announcement of an acquisition, the rising trend in the CAARs has picked up and has sustained itself till one day before the announcement. The CAARs have increased from 0.18 (0.10) during the day -10 to -1 to 0.96 (0.73) for the day -5 to day -1 though the CAARs for none of the above sub-periods are statistically significant. Moreover, maximum returns have been availed during the sub-period -5 to -1. The CAARs for the immediate announcement event window that is for day -1 to day +1 is negative (-0.62, -0.61) though statistically insignificant and the negative trend has continued in the post-acquisition announcement period. Moreover, the negative trend of CAARs for the various sub-periods following the announcement has been statistically significant. The CAARs have declined from -5.28 (-2.70) for the day 0 to day +10 to -5.93 (-2.19) for the day 0 to +20 and the decline has continued till the day 0 to day +50 (-13.02, -3.09).

The diagnosis of the trend of CAARs for various sub-periods makes it evident that except for a marginal rise in CAARs during -10 to -1, the sub-periods following the acquisition have seen substantial wealth destruction. The studies conducted internationally have demon-
strated negative returns for run up to the announcement to the shareholders of the acquiring companies engaged in stock offers but this study has depicted a marginal positive trend before the announcement though it is followed by a decline in CAARs in the post-acquisition period.

Cheung, Rau and Stouraitis (2006) opine that the acquiring companies gain insignificant positive wealth at the announcement of the related party transactions/within-group acquisitions. And in our sample of stock offers, 17 out of total 30 stock offers are within-group stock offers (Table 1). Hence, in order to get better insight into the results of acquiring companies, we have segregated the entire sample into within-group and non-group categories.

The trend of CAARs for the acquiring companies engaged in within-group stock offers as detailed in Table 2 makes it clear that the acquiring companies engaged in within-group stock offers have started gaining positive returns from the 20th day before announcement and it has continued till the actual announcement day. Maximum returns have been earned during the sub-period -5 to -1 (1.96, 1.12) though not statistically significant. But immediately after the announcement day the returns have turned negative and the negative trend has been substantial and statistically significant. Same is visible in the CAARs of sub-period 0 to +10 (-4.94, -1.91), 0 to +20 (-8.93, -2.50) till day 0 to +50 day (-15.55, -2.79).

From the trend of CAARs for acquiring companies engaged in non-group stock offers, it is evident that the CAARs have been negative from the -20th day till the announcement day though minute decline in negative trend is visible during the sub-period -10 to -1 (-0.76, -0.27) to -5 to -1 (-0.35, -0.17). But on the day zero (-0.96, -1.07) and in the subsequent sub-periods, the trend of negative CAARs has sustained though not statistically significant.

Thus, from the above discussion, we can conclude that the reason for the overall sample of stock offers showing positive returns from the day -10 to -1 is due to the positive CAARs earned by the within-group stock offers that sustained till the announcement day for the

Table 3: CAARs Measuring the Announcement Effect for the Target Companies engaged in Cash and Stock Offers

<table>
<thead>
<tr>
<th>Event Periods</th>
<th>CAARs Targets Cash Offers</th>
<th>t Test*</th>
<th>CAARs Targets Stock Offers (overall sample)</th>
<th>t Test</th>
<th>CAARs Stock Offers (within group sample)</th>
<th>t Test</th>
<th>CAARs Stock Offers (non-group sample)</th>
<th>t Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>-50 to -41</td>
<td>4.00</td>
<td>2.01***</td>
<td>-3.29</td>
<td>-1.14</td>
<td>-4.95</td>
<td>-1.22</td>
<td>-1.12</td>
<td>-0.31</td>
</tr>
<tr>
<td>-40 to -31</td>
<td>3.69</td>
<td>1.85*</td>
<td>1.24</td>
<td>0.43</td>
<td>-0.68</td>
<td>-0.17</td>
<td>3.76</td>
<td>1.04</td>
</tr>
<tr>
<td>-30 to -21</td>
<td>4.22</td>
<td>2.12**</td>
<td>4.57</td>
<td>1.59</td>
<td>3.11</td>
<td>0.77</td>
<td>6.49</td>
<td>1.80*</td>
</tr>
<tr>
<td>-20 to -11</td>
<td>2.75</td>
<td>1.38</td>
<td>-0.58</td>
<td>-0.20</td>
<td>-4.39</td>
<td>-1.09</td>
<td>4.41</td>
<td>1.22</td>
</tr>
<tr>
<td>-10 to -1</td>
<td>8.95</td>
<td>4.49***</td>
<td>0.36</td>
<td>0.12</td>
<td>1.89</td>
<td>0.47</td>
<td>-1.64</td>
<td>-0.45</td>
</tr>
<tr>
<td>-5 to -1</td>
<td>7.23</td>
<td>5.13***</td>
<td>1.03</td>
<td>0.51</td>
<td>2.45</td>
<td>0.86</td>
<td>-0.83</td>
<td>-0.33</td>
</tr>
<tr>
<td>Day zero</td>
<td>3.23</td>
<td>5.87***</td>
<td>0.35</td>
<td>0.38</td>
<td>-0.29</td>
<td>-0.23</td>
<td>1.19</td>
<td>1.04</td>
</tr>
<tr>
<td>-1 to +1</td>
<td>6.90</td>
<td>6.33***</td>
<td>0.69</td>
<td>0.44</td>
<td>1.21</td>
<td>0.55</td>
<td>0.01</td>
<td>0.01</td>
</tr>
<tr>
<td>-4 to +1</td>
<td>11.15</td>
<td>7.23***</td>
<td>2.60</td>
<td>1.17</td>
<td>3.76</td>
<td>1.20</td>
<td>1.08</td>
<td>0.39</td>
</tr>
<tr>
<td>-5 to +5</td>
<td>13.45</td>
<td>6.44***</td>
<td>-4.82</td>
<td>-1.60</td>
<td>-5.39</td>
<td>-1.27</td>
<td>-4.08</td>
<td>-1.08</td>
</tr>
<tr>
<td>0 to +5</td>
<td>6.21</td>
<td>4.03***</td>
<td>-5.85</td>
<td>-2.62***</td>
<td>-7.83</td>
<td>-2.50**</td>
<td>-3.25</td>
<td>-1.17</td>
</tr>
<tr>
<td>0 to +10</td>
<td>4.30</td>
<td>2.06**</td>
<td>-9.43</td>
<td>-3.12***</td>
<td>-11.31</td>
<td>-2.66***</td>
<td>-6.97</td>
<td>-1.84*</td>
</tr>
<tr>
<td>0 to +20</td>
<td>4.08</td>
<td>1.41</td>
<td>-11.43</td>
<td>-2.74***</td>
<td>-13.55</td>
<td>-2.31***</td>
<td>-8.64</td>
<td>-1.65*</td>
</tr>
<tr>
<td>0 to +30</td>
<td>7.65</td>
<td>2.18</td>
<td>-14.51</td>
<td>-2.86***</td>
<td>-18.08</td>
<td>-2.54**</td>
<td>-9.86</td>
<td>-1.55</td>
</tr>
<tr>
<td>0 to +40</td>
<td>8.97</td>
<td>2.22**</td>
<td>-18.37</td>
<td>-3.15***</td>
<td>-21.77</td>
<td>-2.66***</td>
<td>-13.91</td>
<td>-1.91*</td>
</tr>
<tr>
<td>0 to +50</td>
<td>8.95</td>
<td>1.99***</td>
<td>-20.55</td>
<td>-3.16***</td>
<td>-25.45</td>
<td>-2.78***</td>
<td>-14.15</td>
<td>-1.74*</td>
</tr>
</tbody>
</table>

* t-statistics has been computed as \( t = \left( \frac{\sum \text{AAR}/\delta_{\text{AAR}} \cdot \sqrt{N}}{1} \right) \), where AAR is the average abnormal return of all the securities from day \( t_1 \) to \( t_f \), \( \delta_{\text{AAR}} \) is the standard deviation of AAR over the estimation period \( (t = -200 \) to \( t = -51) \) and \( N \) is the number of days over which AAR is cumulated.

* \( p \) value < 0.10, ** \( p \) value < 0.05, *** \( p \) value < 0.01 respectively.
within-group mergers only while value has got destroyed in case of non-group stock offers.

Target companies’ returns: The trend of CAARs for the target companies engaged in cash and stock offers over various sub-periods has been detailed in Table 3. Firstly, the announcement returns of the target companies engaged in cash offers have been discussed followed by the discussion of the announcement returns of the target companies engaged in stock offers.

Announcement returns of target companies’ engaged in cash offers: The CAARs for target companies engaged in cash offers over different event periods are given in Table 3. From the trend of CAARs, it is clear that the market has started giving positive reaction to the stocks of target companies engaged in cash offers from the 20th day before the announcement and it has sustained till the 5th day after the announcement. During the pre-acquisition period, the CAARs have risen substantially from 2.75 (1.38) during the sub-period -20 to -11 to 8.95 (4.49) during the sub-period -10 to -1, though slight decline is seen in CAARs during the sub-period -5 to -1 (7.23, 5.13). Maximum positive returns have been availed of during the sub-period -5 to +5 (13.45, 6.44), followed by the sub-period -4 to +1 (11.15, 7.23). The returns of immediate announcement period, that is, for the day -1 to day +1 (6.90, 6.33) have been positive as well as statistically significant. In the post-acquisition period, the rising trend has sustained itself till the 5th day after announcement though afterwards the trend has been random till the 20th day after the acquisition announcement.

Announcement returns of target companies’ engaged in stock offers: The results of CAARs availed of by target companies engaged in stock offers for various event periods are listed in Table 3. It is evident that the CAARs for the target company engaged in stock offers have started rising from the 10th day before announcement and has continued till one day after announcement. During the pre-acquisition period, the CAARs have increased from 0.36 (0.12) for the sub-period -10 to -1 to 1.03 (0.51) for the sub-period -5 to -1. The CAARs of the three-day window (day -1 to day +1) has been marginally positive but statistically insignificant (0.69, 0.44). Moreover, maximum returns have been earned during the sub-period -4 to +1 (2.60, 1.17). However, one day after the announcement, the CAARs have turned highly negative and the negative trend has continued in the post-acquisitions period also. The same is visible in the CAARs of day 0 to +10 (-9.43, -3.12), day 0 to day +20 (-11.43, -2.74) and so on.

Further, from the segregation of total sample into within-group and non-group categories, it is evident that for the within-group stock offers, the rising trend of CAARs has picked up from the 10th day before announcement and has sustained itself till one day after the announcement except for the minute negative return on day zero. The CAARs have risen from -4.39 (-1.09) during the sub-period -20 to -11 to 1.89 (0.47) during the sub-period -10 to -1 and further to 2.45 (0.86) during the sub-period -5 to -1. Maximum positive returns have been earned during day -4 to day +1 (3.76, 1.20), followed by sub-period -5 to -1 (2.45, 0.86) though the increase in the CAARs...
has been statistically insignificant. However, immediately one day after the announcement, the returns have turned negative and the negative trend has continued till the 50th day after the announcement.

While analysing the trend of CAARs for non-group stock offers, it is clear the CAARs have been negative through various event periods except for the marginal and insignificant rise during the day -4 to day +1 (1.08, 0.39). But, immediately after the day zero, the returns have turned negative and have continued the statistically significant negative trend in the post-acquisition announcement period.

Thus, from the above analysis, it can be inferred that both within-group and non-group stock offers have created maximum value for the target companies’ shareholders during the sub-period -4 to +1 and that is the reason for the overall sample of stock offers having shown maximum positive returns during this sub-period. However, immediately after the announcement, both the sets of stock offers are accompanied by negative returns, this being the reason for the overall sample for the target companies’ shareholders showing statistically significant negative returns in the period immediately following the acquisition announcement.

The diagnosis of the trend of CAARs for the acquiring and the target companies engaged in both cash and stock offers makes it clear that, as expected, the cash acquisitions has created substantial and sustainable value for both the acquiring and the target company shareholders. However, in case of stock offers, the acquiring companies have gained positive value for the sub-category of within-group stock offers only while non-group stock offers have destroyed value. Target company shareholders have gained positive value for both within-group and non-group stock offers. Nevertheless, value created in within-group stock offers is more than that of non-group stock offers of the target company shareholders. The a priori research supports the results for non-group stock offers, however, it is inconsistent with the results depicting positive value creation for within-group stock offers especially for the acquiring companies. Hence, in the next section, we have further tried to explore the reasons for these inconsistent findings.

**Tunnelling Effect vs Value Added Effect**

The review of literature highlights two viewpoints regarding the findings of positive value creation for acquiring companies in within-group stock offers (as detailed in the previous section). One viewpoint relates to the tunnelling effect whilst the other relates to the value added effect.

Tunnelling is the process whereby the controlling shareholders expropriate the money of minority shareholders. It states that in the absence of good corporate governance mechanism, in the companies belonging to the same business group with concentrated ownership, there is always a conflict of interest between the controlling shareholders and the minority shareholders and this conflict motivates the former to carry out strategies that maximize their own wealth at the expense of minority shareholders (Bae, Kang and Kim, 2002; Cheung, Rau and Stouraitis, 2006).

Riyanto and Toolsema (2008) opine that the probability of expropriation of minority shareholders funds on the part of controlling shareholders is more pronounced in the case of pyramidal ownership structure.³ The reason being in the pyramidal ownership structure there is a divergence in the control rights (voting rights) and cash flow rights because the controlling shareholder has complete control over all the companies down the pyramid but the cash flow rights are limited to the extent of indirect shareholding. Hence, in such ownership structure, the ultimate owner tries to adapt the strategies that shift the resources from the companies where it has lower cash flow rights to the companies where it has higher cash flow rights in order to maximize his own wealth at the expense of minority shareholders. Johnson et al. (2000) suggest that in addition to the various other ways

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³ The pyramidal ownership structure is such where the holding company or the ultimate owner has control over all the firms in the pyramidal with little or no cash flows (Phani et al, 2005). It happens when a holding company (generally a family) achieves the control of constituent companies by a chain of ownership relation that is, a holding company directly controls a company which in turn controls another company which might itself control another company and so on (Almeida and Wollenzon, 2005). For example, a holding company (say company A) holds 50% stake in another company (say company B) which in turn holds 50% stake in the another company (say company C). Due to this ownership structure, company A has got cash flow rights to the extent of 25% (50%*50%) in the company C. Though cash flow rights of company A are limited to the extent of 25% but it is able to control company C because it has right to influence indirectly, via company B, various strategic decisions of company C. This divergence in the cash flow rights and controlling rights of company A over company C creates similar conflict of interest between controlling and minority shareholders as is between managers and owners in case of dispersed ownership that is, agency conflict (Ariffin, 2009).
(theft or fraud, issue of dilutive shares), acquisitions between the affiliated companies are also one way of siphoning the resources by the controlling shareholders out of within-group acquiring or target companies. Moreover, Wen and Xu (2008) study the Chinese acquisitions and find that related party acquisitions destroy value as compared to non-related party acquisitions since these are aimed at shifting the resources from a listed group company to the unlisted acquired subsidiary.

The second view related to the value creation in within-group stock offers is the value added view that states that business groups with concentrated ownership allow their group companies to allocate resources to the best use through formation of internal capital market where group companies can pool internally generated cash flows (Bae, Kang and Kim, 2002). Hence, as per this hypothesis, the companies belonging to the business groups and having concentrated ownership do not use acquisitions as a mode of shifting resources. Rather, they use acquisitions between the group companies to achieve various financial and economic synergies. Cheung, Rau and Stouraitis (2006) find that the companies announcing connected party transactions have experienced large value losses at the announcement of the inter-firm transactions such as asset sales, equity sales, cash payments, etc. However, in case of within-group acquisitions or related party acquisitions, they experience insignificant positive returns. Further, prior research shows that in the companies with concentrated ownership, there is lesser chance of owner-managers carrying value-destruction strategies as in that case their own interests are aligned with that of the company and they have to bear the major chunk of value destruction (Amihud, Lev and Travlos, 1990; Hubbard and Palia, 1995; Sarkar and Sarkar, 2000; Faccio and Masulis, 2004 and Pant and Pattanayak, 2007).

Hence, the above discussion leads us to two inferences. One, that acquisitions by controlling shareholders belonging to a business group are aimed at shifting the resources in favour of the ultimate owner and the probability of tunnelling of resources is more pronounced in case of acquisitions between the companies belonging to the same business group. So, we hypothesize that if tunnelling is the objective of within-group acquisitions and investors/market anticipate such behaviour on the part of the controlling shareholders, then they will bid down the stock prices of such group companies on the announcement of such acquisitions. Also, as this tendency of shifting resources increases at the higher level of ownership, more value destruction will be seen on the announcement of the acquisitions by the group companies with concentrated ownership. Thus, both the acquiring and the target companies should face value destruction on the announcement of within-group acquisitions and this should increase with the increase in the level of concentration of the ultimate owners’ shareholdings.

On the contrary, if value addition is the objective of within-group acquisitions by the controlling shareholders, then both the acquiring and the target companies should earn positive market reaction on the announcement and it should increase with the increase in the level of ownership.

Bertrand, Mehta and Mullainathan (2002) support the existence of pyramidal ownership structure in India that in turn leads to tunnelling of resources within the group companies by the controlling shareholders at the expense of minority shareholders. As our research has found that positive value has been created for the acquiring and the target company shareholders in within-group stock offers only, it is interesting to know whether that value has been created for these offers at a higher level of ownership due to convergence of interest and declines at a lower level of ownership (that is whether the value addition view is the explanation of such findings) or it is created at a lower level of ownership and declines at a higher level of ownership due to controlling shareholders’ tendency to pursue such acquisitions for shifting resources (that is tunnelling is the explanation of our prior findings).

Hence, to discern which of the above two hypotheses support our prior findings, we try to measure the interaction between the announcement returns and insiders’/promoters’ ownership for stock offers for both the acquiring and the target companies. The reason for taking only stock offers is that it is only in stock offers that segregation of within- and non-group offers is prevalent while all cash offers are non-group ones (Table 1). The owners’/promoters’ ownership has been divided into three categories that is, OWN <15 per cent, OWN 15-49 per cent, and OWN > 49 per cent (controlling shareholding). Further, the result of the three-day win-
Interaction of announcement returns and promoters’ ownership for the acquiring and the target companies:

It is clear from the above table that at the lowest level of ownership category (OWN <15%), the overall sample of stock offers has destroyed value to the extent of -3.51 (-1.24). Moreover, the value destruction is seen for both within-group (-5.97, -1.69) as well as non-group (-2.68, -0.74) stock offers. As the level of ownership increases to the category OWN 15-49%, the value has improved to -1.81 (-1.56) for the overall sample of stock offers, -2.47 (-1.44) for the within-group stock offers and lastly to -0.83 (-0.46) for the non-group stock offers. Furthermore, as the ownership level reaches the category OWN >49 per cent, all sets of stock offers have created a positive value. The overall sample of stock offers have created value to the extent of 2.05 (1.05), while the within-group and non-group stock offers have created value to the extent of 1.17 (0.51) and 3.58 (1.04) respectively.

Similar results are found for the target company shareholders as shown in Table 4. For the category OWN <15 per cent, the value has got destroyed on announcement for the overall sample of stock offers (-2.52, -0.74) as well as for within-group (-5.32, -1.05) and non-group (-1.13, -0.25) stock offers. With the increase in the level of ownership to the category OWN 15-49 per cent, the value has improved for the overall sample of stock offers (-0.84, -0.32) as well as for the within-group (-4.05, -0.73) and non-group (1.00, 0.11) stock offers. At the highest level of ownership (category OWN >49%), the overall

Table 4: Three Day CAARs of the Acquiring and the Target Companies Engaged in Stock Offers segregated by Insider Ownership and Method of Payment

<table>
<thead>
<tr>
<th>Promoters’ Ownership in Acquiring Companies</th>
<th>Mode of Payment</th>
<th>OWN&lt; 15%</th>
<th>OWN 15-49%</th>
<th>OWN &gt; 49%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock offers</td>
<td>CAARs</td>
<td>-3.51</td>
<td>-1.81</td>
<td>2.05</td>
</tr>
<tr>
<td></td>
<td>t test</td>
<td>-1.24</td>
<td>-1.56</td>
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</tr>
<tr>
<td></td>
<td>No. of cases</td>
<td>3</td>
<td>11</td>
<td>16</td>
</tr>
<tr>
<td>Within-group stock offers</td>
<td>CAARs</td>
<td>-5.97</td>
<td>-2.47</td>
<td>1.17</td>
</tr>
<tr>
<td></td>
<td>t test</td>
<td>-1.69***</td>
<td>-1.44</td>
<td>0.51</td>
</tr>
<tr>
<td></td>
<td>No. of cases</td>
<td>1</td>
<td>4</td>
<td>12</td>
</tr>
<tr>
<td>Non-group stock offers</td>
<td>CAARs</td>
<td>-2.68</td>
<td>-0.83</td>
<td>3.58</td>
</tr>
<tr>
<td></td>
<td>t test</td>
<td>-0.74</td>
<td>-0.46</td>
<td>1.04</td>
</tr>
<tr>
<td></td>
<td>No. of cases</td>
<td>2</td>
<td>7</td>
<td>4</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Promoters Ownership in Target Companies</th>
<th>Mode of Payment</th>
<th>OWN&lt; 15%</th>
<th>OWN 15-49%</th>
<th>OWN &gt; 49%</th>
</tr>
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<tbody>
<tr>
<td>Stock offers</td>
<td>CAARs</td>
<td>-2.52</td>
<td>-0.84</td>
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<td>No. of cases</td>
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<tr>
<td>Within group stock offers</td>
<td>CAARs</td>
<td>-5.32</td>
<td>-4.05</td>
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<td>t test</td>
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<tr>
<td>Non-group stock offers</td>
<td>CAARs</td>
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<td>-1.15</td>
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<tr>
<td></td>
<td>t test</td>
<td>-0.25</td>
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<tr>
<td></td>
<td>No. of cases</td>
<td>2</td>
<td>7</td>
<td>4</td>
</tr>
</tbody>
</table>

^ 'No. of cases' means number of companies which is different for various levels of ownership

^^ t-statistics has been computed as $t = \left( \frac{\sum AAR / \delta_{AAR} \cdot \sqrt{N}}{\sqrt{N}} \right)$, where AAR is the average abnormal return of all the securities from day $t_1$ to $t_n$, $\delta_{AAR}$ is the standard deviation of AAR over the estimation period ($t = -200$ to $t = -51$) and $N$ is the number of days over which AAR is cumulated.

* $p$ value < 0.10, ** $p$ value < 0.05, *** $p$ value < 0.01 respectively.
sample of stock offers has shown an improvement in the value to the extent of 2.35 (1.20) while value has increased in within-group stock offers to 3.51 (1.49), though it has declined marginally in case of non-group stock offers to -1.15 (-0.39).

As the upshot of the above discussion, we can state that as the ownership level increases, the value creation improves in case of the sample for overall stock offers for both the acquiring and the target company shareholders. Moreover, value has shown improvements in the case of within-group stock offers (where the probability of tunnelling of resources is more pronounced on the part of the controlling shareholders) while it has got destroyed slightly for non-group ones at the highest level of ownership in the case of target companies. Bertrand, Mehta and Mullainathan, (2002), who analysed the extent of tunnelling in Indian business groups, found that the probability of tunnelling is lesser in those group companies where promoter family has higher equity stakes as there are fewer minority shareholders whose funds are to be expropriated. We have also found that positive abnormal returns have been earned by the acquiring and the target companies for those within-group stock offers where promoters’ shareholding is highest.

Bertrand, Mehta and Mullainathan (2002) also state that if the purpose of acquisitions by a business group is aimed at tunnelling and if markets are efficient, then such an act of takeover would generate one time drop in share prices of the acquiring company to the extent of tunnelling. However, our results are contrary to this viewpoint. It may be due to two probable reasons as suggested by Riyanto and Toolsema (2008). Firstly, the investors are myopic and can not identify tunnelling. Secondly, such acquisitions are aimed at propping the operations of a group company (down the pyramid) that is in financial distress. If this is the case then stock markets would rather deliberately accept such tunnelling and welcome such acquisitions because it gives a hope to the shareholders of the acquiring company that in case the acquiring company itself faces financial distress in future, other group companies’ resources would be shifted towards it to lift it up from bankruptcy.

Besides, our results are consistent with that of Cheung, Rau and Stouraitis (2006), who have found that the acquisition of firms within the same business group generally benefit the shareholders and found the two-day return (day 0 and day +1) in case of within-group acquisitions to be positive though not statistically significant.

Hence, we can deduce that in India, the objective of within-group stock offers by controlling shareholders is to enable the group companies to restructure the operations of other group companies and to create various financial and operating synergies by pooling their resources internally and is not aimed at shifting the resources from one group company to another or towards themselves for maximizing their benefits at the expense of minority shareholders. That is the reason for the stock market’s positive reaction to the announcement of within-group stock offers in India. Hence, our results are supported by the value added view.

Sarkar and Sarkar (2000) who studied the relationship between promoters’ ownership and firm valuation in the context of organic growth of business groups in India also support the prevalence of value added view in India and conclude that, in the business groups, once the ownership level goes beyond 25 per cent, the probability of controlling shareholders expropriating minority shareholders’ money reduces because of the convergence of their interest with that of the company.

**KEY FINDINGS**

The main findings of the study based on the above discussed results can be summarized as follows:

Firstly, maximum value has been created for the shareholders of the target companies engaged in cash offers followed by the shareholders of acquiring companies engaged in cash offers, target companies’ shareholders engaged in stock offers, and lastly for the acquiring companies’ shareholders engaged in stock offers. The results are in confirmation with the information asymmetry hypothesis. It is due to the information asymmetry regarding the valuation of target companies’ assets that acquiring companies have used either stock or cash. Depending upon the mode of financing employed, the stock market has given differing reaction to the stocks of the acquiring and the target companies. The stock markets have given positive and statistically significant returns to the announcement of cash offers to both the

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\[4\] Propping is the other form of tunnelling with the difference that here funds are transferred from higher level to lower level companies in the pyramid and is usually aimed at saving the company down the pyramid from bankruptcy.
acquiring and the target companies considering these to be less risky.

Secondly, target companies have earned positive returns in case of both stock offers as well as cash offers though larger value has been created in the latter. Acquiring companies have also gained from cash offers but most of the value has been carried away by the target shareholders. The result is supported by the taxation hypothesis which states that the acquiring companies earn lesser returns in cash offers as compared to target companies because the acquiring companies generally overpay in such acquisitions.

Thirdly, the market reaction to stock offers has been positive not only for the target companies but for the acquiring companies as well. Nonetheless, positive value has been created only in within-group stock offers. Thus, division of stock offers into within-group and non-group categories reveals that the stock markets have interpreted stock offers as a riskier strategy for non-group mergers but for within-group mergers, these have been considered as a positive action on the part of the acquiring companies.

Lastly, the value has improved with the increase in the level of ownership for within-group stock offers (that are more susceptible to tunnelling of resources by controlling shareholders). Thus, it can be inferred that controlling shareholders do not pursue within-group stock offers just to shift resources from one group company to another group company or towards themselves for their personal benefits. Rather, these are aimed at adding value to shareholders by realizing various operating and financial synergies by combining the resources of group companies. Thus, the results are in corroboration with the value added view in case of within-group stock offers.

LIMITATION OF THE STUDY AND SCOPE FOR FUTURE RESEARCH

The small sample size of 13 for non-group stock offers and 17 for group stock offers restricts the generalization of the results. Hence, readers may cautiously draw broader conclusions from the study regarding the aspect of value creation in within-group and non-group stock offers for acquiring companies. Research can be further conducted on insider trading in M&As to isolate its effect from market anticipation by segmenting the pre-acquisition announcement period into two parts as explained by Sanders and Zdanowicz (1992). One part would deal with the pre-acquisition period beginning from the initiation date when the unpublishized talks of mergers start between the acquiring and the target company while the other part would relate to the pre-acquisition period before the actual announcement date. Further, volume of the shares traded before the announcement period (an important indicator of insider trading) can also be studied to decipher the extent to which insider trading is prevalent in within-group and non-group stock offers.

CONCLUSION

From the above discussion, we can conclude that differences in announcement period returns of both the acquiring and the target companies are a function of the mode of financing employed in acquisitions. Cash offers receive positive stock market reaction since these highlight acquirer’s confidence in actually realizing the synergies in the post-acquisition period. Whereas stock financing is employed by an acquirer for risky acquisitions, therefore, stock market gives negative response to the announcement of such acquisitions. Besides the mode of payment, ownership structure is also an important factor since it highlights the intentions of the insiders/promoters towards value creation/destruction in an acquisition. It has been found that the concentration of ownership in the hands of promoters align their interest with that of the company and this restricts the possibility of controlling shareholders pursuing risky and value destroying acquisitions. In India, even the within-group stock offers that are highly prone to tunnelling of resources by the controlling shareholders, are rather aimed at creating synergies by pooling the resources of the group companies. That is the reason why stock market gives positive reaction to the announcement of within-group stock offers. Thus, in a market with imperfect information, mode of payment along with ownership structure are the cues through which the market (investors at large) can make an assessment about the value creating potential of an acquisition.
REFERENCES


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