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An Empirical Study on the Open Offer Size & Mode of Payment and Its Effect on Shareholders Wealth of Target Companies in India

Rajit Verma¹ and Anil K. Mittal²

Abstract

In the present vulnerable environment every organization is going under a distress phase due to many uncontrollable factors. To overcome from such phase it is essential for the corporate to bring restructuring in the organization to restore the financial health and mergers, acquisitions and the takeovers are the famous methods of corporate restructuring. The current study focusing on the takeover announcements using the open offer (SAST 2011). The study included 24 large sized open offer announcements for the investigation purpose i.e. more than 100 crore rupees. The standardized event study methodology has been used to compute the abnormal returns during the event window of 61 days and resulted in generation of abnormal returns during the post phase of announcements. Finally study concluded with the remarks that findings of the study is consistent with the prior studies mentioned in the literature and supported the semi strong form of market efficiency in India.

Keywords: Event study, Event window, Open Offer, Takeovers

1. Introduction

In recent years open offer has become an important method of takeover for many Indian firms. Open offer is an announcement made by the acquiring company for the shareholders of target company in the case when acquiring company along with some other individuals with same motive wants to procure twenty five percent or excess holdings in the target firm (According to Substantial acquisition of shares and takeovers regulations 2011). The rationale behind the decision of open offer is that it can be used for the purpose of mergers and acquisitions. Three motives of takeover are analyzed in the theoretical framework i.e. substantial acquisition of shares, consolidation of holdings, and change in management. Open offer gives an advantage to the shareholders to maximize their return by participating in the event.

Table 1: Threshold Limits under Open Offer (As per SEBI SAST 2011)

Offer Size	By a person along with PAC holding 25% or more shares and announcing Voluntary Open Offer	By a person along with PAC holding less than 25%
Minimum Offer Size	10 percent	26 percent
Maximum Offer size	Maximum permissible non public shareholding	Can be entire share capital of Target firm

Source: www.sebi.gov.in/SAST2011

1. Research Scholar, Kurukshetra University
2. Professor, Kurukshetra University

Determination of Pricing under Open Offer

The pricing of Open Offer is the most important element in whole process. Usually the open offers are on the premium to the market rate. Securities and exchange board of India took various steps to provide a framework for the pricing. As per SEBI SAST (2011) Section 8 (2) in the case of direct and indirect method of shares acquisition, or control in the small firm (target company), where the key points mentioned in sub clause (2) of direction 5, the price of open offer would be the highest as mentioned in the table below:

Table 2: Price Determination under Open Offer as per SAST 2011

	Price discovery under Open Offer regulation 8 of SAST (2011)
Either	For any acquisition of shares of target firm, the ever highest arranged price which triggered to make the open offer announcement.
Or	In the last 52 weeks the volume-weighted average price paid or before the date of open offer announcement
Or	During the last 26 weeks the Maximum (highest) price paid or payable for any acquisition before the open offer announcement date.
Or	The weighted average price based on the volume trading of shares for a period of 60 trading days before the announcement day where the volume of trade of shares of target firm was highest.
Or	In case shares of target firm is not frequently traded on any exchange than the open offer manager considers the factors of valuation which includes, book value, similar trading multiples etc.

Source: www.sebi.gov.in/SAST2011

Mode of Payment Consideration under Open offer (Section 9 of SAST 2011)

Section 9 (1) Open Offer price can be paid as per following ways: a) Cash payment, or b) Issuing, exchanging or transferring the shares of the acquirer or PAC, c) Issuing, exchanging or transferring of secured debt instruments issued by the acquirer or PAC, d) Issuing, transferring or exchanging the convertible debt securities; or e) A mix of the method of payment mentioned above:

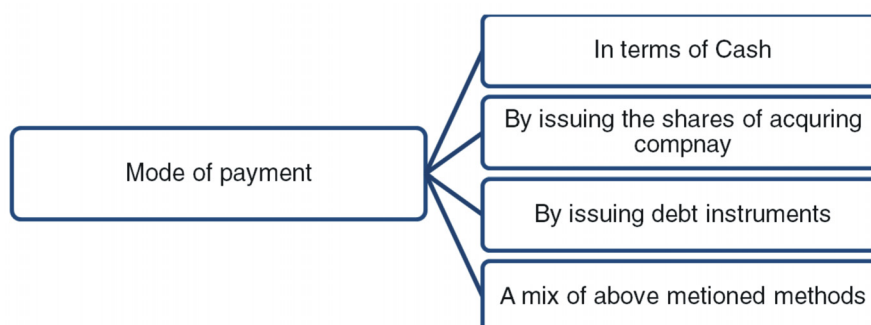


Figure 1: Mode of Payment Consideration under Open Offer

Source: www.sebi.gov.in/SAST regulations 2011

2. Literature Review

Dodd and Ruback (1977), Jensen and Ruback (1983), Bradley *et al.* (1988) and Jarrell and Poulsen (1989) examined in their respective studies the impact of tender offers in United States of America. The study suggested that the target companies earned significant positive abnormal returns during one month after the announcement date. Firth (1980), Franks and Harris (1989) and Limmack (1991) analyzed the acquisition and takeover announcements impact on the target companies in the United Kingdom and the shareholders earned substantial gains during and after the announcement date. Samuelson, Rosenthal (1986) found that the movement in the share prices of objective firms is a predictor of the acceptance or rejection of open offer. It was found that the price of open offer during the event window matched with expected share price at the closing date of the offer. Fabozzi *et al.* (1988) analyzed that the returns of failed tender offers got no other bids in the post failure year. Wansley *et al.* (1989) investigated that there are five major determinants of Offer Premiums 1. dividend Substitute hypothesis; 2. Leverage hypothesis; 3. Price pressure hypothesis; 4. Anti-takeover hypothesis; and 5. Information signaling hypothesis. A survey was conducted on CEO's of large firms in US. All parties agreed with the information signaling hypothesis both as a reason for repurchase and as a important component of premium. Lakonishok and Vermaelen (1990) undertook very influential study to examine anomalous price behavior around takeover tender offers & it was analyzed that the abnormal returns prior and after the expiration of the offer varies in short run. Datta, *et al.* (1992) explained in their study about wealth creation using M&A announcements in USA. The shareholders of the target companies gained significant returns as they participated in such offers. Singh *et al.* (1994) analyzed that Open Offer programs do not allow for precise estimate of price movement intensity to measure liquidity effects. Pandey (2001) examined that the open offer announcements and its effect on the share returns of objective firm further it examined the impact of change in control of firm on gains of shareholders. Bruner (2002) analyzed the effects of takeover announcements on the wealth of shareholders of target companies and found out that such announcements provided abnormal market return to the shareholders. Oded (2005) empirically tested the objective that why the firms announce open offer programs. It was analyzed that the announcement is not a commitment. Gupta (2006) makes an attempt in his study to find the announcement returns for seven subsequent repurchases. He observes a decline in the AAR for -1, 0 and +1 days for five companies announcing second repurchase programme as compared to first repurchase announcement. Iqbal *et al.* (2007) provided evidence about the long run operating and stock performance of UK open offers. Pandey (2001) and Chakraborty (2010) discussed the reaction of takeover announcements on the price movement of the target companies in the short run i.e. 61 days event window. Pandey analyzed the impact on large cap companies and Chakraborty used various parametric and non-parametric tests and apparently they found out that the shareholders can gain significant abnormal return in the short run and not in the long run as they buy and hold for a longer duration. Nangia *et al.* (2011) examined and empirically tested the excessive earnings generated before and after the announcement date. It was observed that average returns and cumulative average returns of all the sample firms generated negative returns in long run (after event window), but generated positive returns in the short run. Mallikarjunappa and Nayak (2013) discovered the effects of target announcements on the wealth of target firms' shareholders. The study used a sample of 227 companies which announced takeovers during the period 1998 to 2007. The study found significant results and results were consistent with prior studies.

3. Research Methodology

Objectives of the Study

- To analyze the size of open offer and its effect on shareholders wealth of target companies.
- To examine the mode of payment for consideration in the open offer process.

Sampling Design

In order to achieve above stated objectives the companies are selected on the basis of the following criteria:

- The study examined the wealth effects of target companies' shareholders only and the wealth effects of acquiring firms has not been considered for the present study
- All the target companies should be listed on the Bombay Stock Exchange (S&P BSE 500) and must have sufficient number of trading days for the calculation of an estimation window of 120 days. The data should be available for computation for an event window 61 days (30 days before, 30 days after and the day of announcement, i.e., day '0')
- The study included only those open offers which are large in size (above 100 crore rupees).
- All the multiple announcements such as dividend announcement/ buyback announcement/ stock split announcements relating to the companies given in the sample if found out would be eliminated for the calculations. As it can neutralize the impact of open offer announcements.
- S&P BSE 500 as a market index is being used as a proxy for the market model to predict the expected returns of the securities using Ordinary Least Square regression modeling (OLS) and for the calculation of estimation errors Sharpe Market Model (1963) has been considered.

Total 31 companies have announced the open offer which has the value of more than 100 crore rupees during the period April 2015 to March 2017 which were reduced to 24 after using above mentioned criteria. The table below revealing the year wise open offer announcements:

Hypotheses: The null hypotheses are mentioned below which states that average abnormal returns and cumulative average abnormal returns during event window is equals to zero.

H1: AAR=0

H2: CAAR=0

Table 3: List of Large Sized Open Offer Announcements during 2014-2017

Open Offer announcements during April 2015- March 2017	
Years	Total
2014-15	8
2015-16	10
2016-17	6
Total	24

Source: www.sebi.gov.in

Brown and Warner (1980) and Fama, French (1991) event studies focused on the impact of events which provide the strong evidences to predict the market efficiency in both long term and short term. Standardized event study examines the price behavior of the specified companies before and after the event date and it also takes in to the consideration abnormal gains and losses during the event window. For the current study three things are essential i.e. Estimation window (to calculate expected return), Event window (Pre and post period of event) and event day (date of public announcement). Estimation window has 120 days (-150 to -30), event window has the size of 61 days (-30, 0 day and + 30).

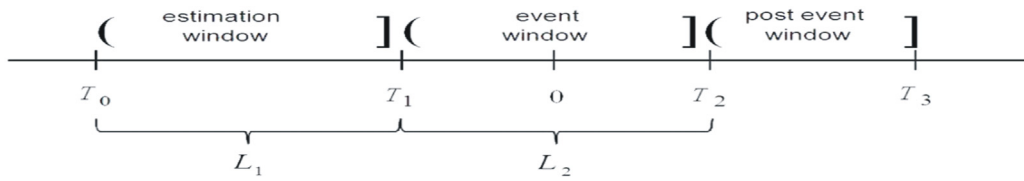


Figure 2: About Estimation Window and Event Window

Research Design

The study intended to utilize event study methodology to predict the announcement impact on shareholders' wealth of target companies. As mentioned above the study is categorized in to three parts i.e. estimation window, before announcement date and after announcement date. For the estimation window Ordinary least square regression model (OLS) is used to predict the expected return of the target companies in the event window.

$$R_{i,\tau} = \alpha_i + \beta_i R_{M,\tau} + \epsilon_{i,\tau}$$

R_{it} = stock return of i , $\hat{\alpha}_i$ = Intercept of security i , $\hat{\beta}_i$ = Slope of security i , R_{mt} = Market return

Further to examine the excessive returns or abnormal returns the actual returns of the companies are deducted from expected return and **Sharpe (1963)** market model is used for it.

$$AR_{jt} = R_{jt} - (\alpha'_j + \beta'_j R_{mt})$$

Some of the studies which have followed the above model are Dodd and Ruback (1977), Marsh (1979), Dodd (1980), Dodd and Warner (1983), Wansley *et al.* (1983, 1987), Dyckman *et al.* (1984), Collins and Dent (1984), Brown, and Warner (1980, 1985), Lewellen *et al.* (1985), Jain (1986), Chatterjee (1986), Singh, and Montgomery (1987). This is a very famous and widely used model which predicts the market.

Cumulative abnormal return (CAR) is computed by summing up the total of daily abnormal returns over the complete event window cycle (-30, +30).

$$CAR_{i(\tau_1, \tau_2)} = \sum_{t=\tau_1}^{\tau_2} AR_{i,t}$$

The study used log returns to evaluate the performance of the target companies using open offer.

Every day average abnormal returns (AAR_{*t*}) for of the event window is calculated as below:

$$AAR_t = 1/N (\sum_i \hat{OAR}_{it})$$

Cumulative average abnormal returns (CAAR) of the given sample can be computed as:

$$CAAR_{(\tau_1, \tau_2)} = \frac{1}{N} \sum_{i=1}^N CAR_{i(\tau_1, \tau_2)}$$

4. Analysis and Interpretation

The study found that for all the large sized open offers (above 100 crore rupees) during April 2015 to March 2017 & the cash has paid for the payment consideration for all the 24 Open Offers. Further study investigated the announcement impact of open offer on the price movement of objective company. As mentioned earlier the estimation window of 120 days has used to compute the expected returns of the 24 announcements using the OLS regression model and for the purpose of computing estimation error Market Model (1963) has used. The table below shows the average abnormal returns (AAR) and cumulative abnormal returns (CAAR) of all 24 companies during the event widow of 61 i.e 30 days before and 30 days after and 0 event date.

Table 4: Showing the AAR and CAAR of 24 Large Sized Open Offer Announcements during the 61 Days Event Window

Days	AAR	CAAR	Days	AAR	CAAR	Days	AAR	CAAR
-30	0.0099	0.0099	-10	0.0065	0.0094	10	-0.002	0.1162
-29	-0.0048	0.0051	-9	0.0043	0.0137	11	0.0004	0.1167
-28	0.0025	0.0076	-8	-0.001	0.0127	12	-0.0017	0.1149
-27	0	0.0077	-7	0.0066	0.0193	13	0.0047	0.1196
-26	-0.0086	-0.001	-6	0.0251	0.0444	14	0.0038	0.1234
-25	-0.0023	-0.0032	-5	0.0067	0.0511	15	-0.0079	0.1155
-24	-0.0004	-0.0037	-4	0.0099	0.061	16	-0.0045	0.111
-23	0.009	0.0054	-3	-0.0001	0.0608	17	0.0044	0.1154
-22	0.0022	0.0075	-2	0.0091	0.0699	18	-0.0001	0.1153
-21	-0.002	0.0055	-1	0.0117	0.0816	19	-0.0032	0.1121
-20	-0.0056	-0.0001	0	0.0317	0.1133	20	0.0003	0.1123
-19	0.0063	0.0061	1	0.0078	0.1211	21	-0.0028	0.1096
-18	-0.0012	0.0049	2	-0.02	0.1011	22	-0.0045	0.1051
-17	-0.0079	-0.003	3	0.0091	0.1103	23	-0.0033	0.1018
-16	-0.0042	-0.0072	4	0.0002	0.1105	24	-0.0035	0.0984
-15	-0.0003	-0.0076	5	0.0108	0.1213	25	-0.0054	0.0929
-14	-0.0008	-0.0084	6	0.003	0.1242	26	0.0083	0.1012
-13	0.0008	-0.0076	7	-0.0003	0.124	27	-0.0074	0.0938
-12	0.0012	-0.0064	8	0	0.124	28	0.0003	0.0941
-11	0.0093	0.0029	9	-0.0057	0.1183	29	-0.0004	0.0937
						30	-0.0015	0.0922

Source: Authors' computation

The overall results of Average excessive (abnormal) returns (AAR) and cumulative average abnormal returns (CAAR) reflecting that during the pre phase of open offer announcement the target firms' generated only 1% to 5% cumulative average abnormal returns from day -10 to -5 and from day -4 to -1 the companies mentioned in the sample generated 6% to 8% CAAR. But on announcement day and after the announcement period overall gains of the companies increased to 12.34% on the day 14. The results reflecting that on announcement day the CAAR is around 11% and steadily the CAAR increased in symmetric manner. This ultimately increased the wealth of shareholders of the target companies.

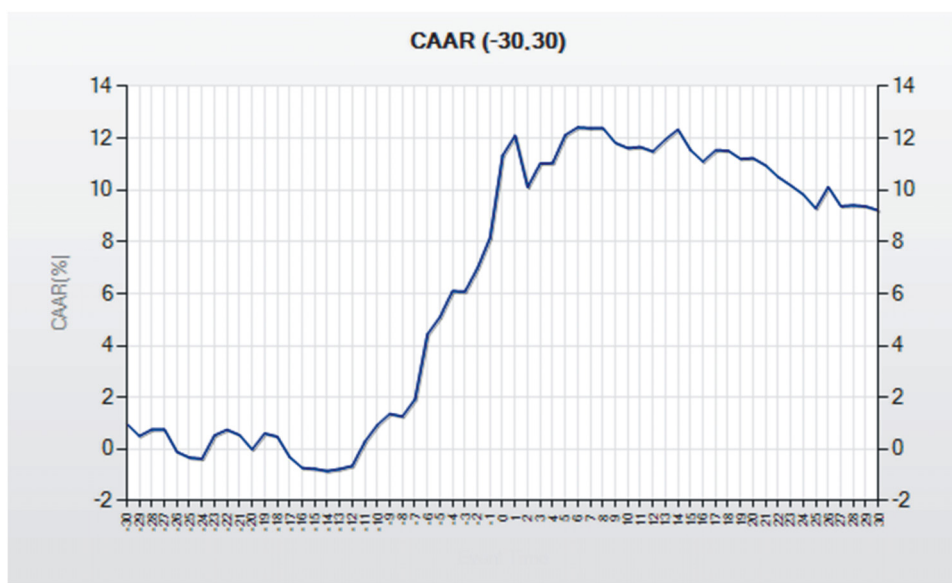


Figure 3: Showing Movement of CAAR of Large Sized Open Offers during the event Window Of 61 Days (-30 Days, 0 Day and +30 Days)
 Source: Authors' computation

The CAAR results clearly depicting the announcement impact on the share price performance of target companies. Further to examine the significance of these excessive returns, various parametric and non parametric tools are used. The study used 1% and 5% level of significance for Cumulative Average Abnormal returns (CAAR) of the target companies and the table below highlighting the results of various test static:

As mentioned previously various test statics has used to examine the significance of announcement effect on the wealth of shareholders in different sub event windows i.e. (-30,30), (-20,20), (-10,10), (-5,5), (-4,4), (-3,3), (-2,2) and (-1,1).. The results of t test indicating that the big event window (-30,30) is showing the significant results at a confidence level of 5% and other sub event window as mentioned earlier showed the significant results at a confidence level of 1%. Hence the null hypothesis is rejected which indicated that CAAR is not equals to zero. T test cross sectional test, Patell z test, Boehmer et al test, Corrado rank test and sign test showed similar results at the different level of confidence. Boehmer test and Corrado test along with Patell z test showed insignificant results in the bigger event window of (-30, 30).

Table 5: Showing the Parametric and Non Parametric Test Statics for the Different Sub Event Windows at Different Level of Significance i.e. 5% and 1%

Event windows	CAAR	Positive : Negative	Time-series t-test	p value	Cross-sectional t-test	p value	Patells' z test	p value	Boehmer et al. test	p value	Corrado's rank sign test	p value	Sign test	p value
(-30...30)	0.0922	13:11	1.8831	0.0597*	1.5143	0.13	2.4314	0.0150**	1.4159	0.1568	1.0142	0.3105	0.9959	0.3193
(-20...20)	0.1068	14:10	2.6615	0.0078**	2.1274	0.0334*	3.478	0.0005**	1.7864	0.074	1.443	0.149	1.407	0.1594
(-10...10)	0.1134	16:08	3.9467	0.0001**	2.6228	0.0087**	4.9237	0.0001**	2.2616	0.0237*	2.0116	0.0443*	2.2293	0.0258*
(-5...5)	0.0769	15:09	3.698	0.0002**	2.2221	0.0263*	3.5098	0.0004**	1.9573	0.0503*	1.5469	0.1219	1.8182	0.069
(-4...4)	0.0594	14:10	3.1565	0.0016**	2.1459	0.0319*	2.9662	0.0030**	1.8013	0.0717	1.0749	0.2824	1.407	0.1594
(-3...3)	0.0493	16:08	2.973	0.0029**	1.9229	0.0545*	3.2613	0.0011**	1.8414	0.0656	1.4175	0.1563	2.2293	0.0258*
(-2...2)	0.0403	16:08	2.8752	0.0040**	1.6766	0.0936	3.3861	0.0007**	1.7371	0.0824	1.1482	0.2509	2.2293	0.0258*
(-1...1)	0.0512	15:09	4.7134	0.0001**	2.3097	0.0209*	5.6505	0.0001**	2.3614	0.0182*	2.3879	0.0169*	1.8182	0.069

Source: Authors' computation (* at 5% confidence level, ** at 1% confidence level)

5. Findings and Conclusion

The study investigated the size of open offer and method of payment consideration and its effects on the wealth of shareholders of target companies in India.

- After analyzing all the open offer announcements made during 2015 to 2017 it was found that only 24 open offers were above 100 crore rupees in size. Further the study found that all 24 large sized open offers used the cash payment for the purpose of making payment of the consideration.
- The study revealed that majority of companies who have large size of open offer (more than 100 crore rupees) for the payment consideration in the cash showed the significant results and found that the companies reacted positively on such open offer announcements. Further the results showed the significant values which are consistent with the prior studies as mentioned in the literature (Pandey (2001), Chakraborty (2010))
- The present study explained the market efficiency in a developing nation like India and found that as new information float in the market than market takes time to absorb the new information as described in the and the effect of open offer carried during the open offer period of 20 days. This analysis indicated and based on the review of various research papers like Brown and Warner (1985), Sudarsanam and Salami (1996), Pandey (2001), Agarwal and Bhattacharjea (2006), Mallikarjunappa and Nayak (2013) which indicating the market efficiency of Indian capital market is falls under the semi strong form.

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