MERGERS AND ACQUISITIONS ROLE TOWARDS SHAREHOLDERS' WEALTH IN THE BANKING SECTOR OF PAKISTAN

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ABSTRACT

Mergers and Acquisitions (M&As) are considered as useful strategies for the purpose of growth and expansion of businesses. The trend of M&As started by the late nineteenth century, this same trend can be foreseen in the financial sector of Pakistan. The objective of this paper was to measure the role of M&As on the shareholders' wealth in Pakistan from 2012 to 2017 in the Banking sector of Pakistan. This was done with the help of event study method in two ways. Firstly, the short term effect was analyzed by abnormal and cumulative abnormal returns (CAR) in 91 days windows period which included 45 days pre and 45 days post-performance. Secondly, long term performance was analyzed using Buy-and-Hold Abnormal Returns (BHAR) with estimation windows of 90, 180, 270 and 360 days. The results revealed that the post-merger period was significantly positive and market responded positively to the phenomenon of M&As for banking sector of Pakistan. Outcomes of this paper will be useful for the management and investors for making investment decisions.

Key words: Mergers and Acquisitions, Returns, Buy-and-Hold Abnormal Returns, Event study Technique.

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1. INTRODUCTION

Mergers and acquisitions (M&A) in the academic research has got substantial interest. Most of the empirical researches focus on the stock returns in short term near the announcement days. Fewer studies analyzed the long term performance of stock returns. Previously various efforts has been made to analyze the merger and acquisitions performance in terms and long term so that measurement techniques can be improved and benchmark issues can be handled and to improve the statistics can be improved [1].

For the purpose of expansion or growth organizations need financial resources[2]. Growth can be achieved when organizations launch a new product or service or by expanding operations beyond the already existing resources. Internal and external resources are the two ways to achieve growth [3]. Mostly the business organizations for expansion of their businesses depend on internal resources which are retained earnings. For considerable growth opportunity, organizations must go for external resources if they are limited on the internal resources within organization. Bank loans, partnerships, acquiring other organizations or merging with any other company are the external sources to achieve growth. In the corporate world, M&As are the rising strategies that are being adopted by the organizations for expanding businesses. And due to the rapid growth this strategy has been adopted by the many organizations, approximately four to five thousand transactions are recorded for M&A every year in business world

There are various reasons mentioned in the literature for the occurrence of M&As between organizations. First reason includes organizational synergy, which states that merged company receives greater value than the individual entity[4]. Second, this strategy may reduce the expenditures of the combined venture resulting in wealth maximization of shareholders, thirdly, for the survival of firm in the dynamic environment, fourthly, to gain economy of scale and lastly to reduce costs to enhance returns on equity[5].

Figure 1

Path a: It will analyze the short-run impact of M&As on the stock returns of firms.

Path b: it will assess the financial performance of the firms in the long run.

According to our best estimate, previous literature provides a proof for the occurrence of M&As in various sectors of the country while for the banking sector of the Pakistan there is adhere need of attention of researchers. These events could have positive, negative or neutral impact on the shareholders wealth in the combined bank. This paper attempts to find out the role of such events on market returns for banking sector of the country, which will be done in two ways, initially this will be analyzed in short run with the help of Abnormal returns and for the long run Buy-and Hold Abnormal returns will be analyzed. The Returns will be analyzed

for the short-run using event study in which 91 and 11 days estimation windows are selected. In the long run, the data will be analyzed with the help of 90, 180, 270 and 360 days estimation window.

2. LITERATURE REVIEW

M&As strategies have gained the global identity in terms of strategic move in the corporate world over the years. Many national as well as international organizations have successfully opted and adopted these strategies, which has brought significant development to the various sectors in the world[6].

In the developed countries, there is quite recognized and effective system to measure the effects of M&As, while in the developing countries; there is lack of systems and an issue for the researchers to measure the effects. This is due to the lack of literature regarding events in the developing economies, because of that these events are investigated separately so that the effects of M&As on financial performance of firms can be calculated [7]. The reasons behind lack of literature can be associated due to various reasons including lack of data, event sources, low usage of these strategies and the scope of M&As in developing countries[6, 7].

The trend of M&As in the context of Pakistan is relatively new and has been seen and adopted from only last two decades. Thus, literature in Pakistan is relatively less as compared to other developing or developed countries[8]. That existing literature in Pakistan showed mixed results in terms of market returns. Other studies concluded that there were the positive and significant results while few reported that there was negative or insignificant impact on the share prices.

A study in the manufacturing sector of Pakistan was conducted, in which events from 2000 to 2009 were analyzed. Study concluded that there was the similarity in the results of observed events with the results of other countries events [9]. Another study was conducted by Mehmood et al [10] in which they analyzed banking and pharmaceutical sector of Pakistan. They experienced mixed results, in which few companies had positive effects on share prices while some had negative impact on share prices.

A study was conducted in the Pakistani context for the banking sector result suggested of M&As did not provide benefits for all firms except few as most of the M&As could not provide returns to share holders and their market values declines due to occurrence of events. Further, results suggested that management did not forwarded efficient decision during the phase of M&As. Lastly, as the results that few of the firms got benefited from the occurrence of events which means there is potential in the banking sector to get benefited from the M&As so firms must carefully choose and opt for M&As by critically analyzing the future potential benefits[11].

Another study was conducted in the Pakistani context, in which post M&As impact was analyzed. In which sample of 8 companies was covered which has gone through the phase of M&As during the period of 2000-2002. From that sample the most companies belonged to banking and pharmaceutical industry of Pakistan. This was analyzed with the event study technique in which post merger and acquisitions performance was analyzed within one month time frame. Results concluded that five companies had positive and significant results while the two companies had negative impact and one company had no impact on the share prices. Overall, study showed that the M& positively affected on the share prices of merged companies [10].

M&As practice is negligible in Pakistan rather than that few studies have been conducted in Pakistani context. A study was conducted by selected the forty five events from the year 2004 to 2010, these events were selected from various sectors of country and were analyzed with the help of event study methodology in the eleven days event window and the results

concluded that the acquired firms neither created and nor destroyed values for the shareholders[8].

3. RESEARCH METHODOLOGY

This study aims to examine the pre and post M&As performance of the banking sector of Pakistan which took place from the year 2012 to 2017. In this paper, the researcher aims to find out the short term effect of M&As as well as the long term effect of the M&As. Short term effect will be studied based on 91 days event period in which 45 days pre and 45 days post-merger performance will be analyzed to calculate expected return, abnormal returns and Cumulative Abnormal Returns of the stocks due to the effect of the announcement of the deals. For this, the market model has been used and stated below.

$$AR_{i,t} = R_{i,t} - (\hat{\alpha}_i + \hat{\beta}_i R_{m,t})$$

Here $R_{i,t}$ represents the return of the company, in which i represents the company and t shows the trading day. KSE is the Benchmark index, it is shown by $R_{m,t}$, and α_i and β_i represent the coefficients of regression of the mentioned company. 91 days cays cumulative abnormal return in the 91 days window calculated with the mentioned formula.

$$CAR_{i,[r_1,r_2]} = \sum_{t=r_1}^{r_2} [R_{i,t} - (\hat{\alpha}_i + \hat{\beta}_i R_{m,t})]$$

Further, for the long term analysis 90, 180, 270 and 360 days post-merger performance of the acquirer firm's will be analyzed with the help of Buy-and-Hold Abnormal Return[12]. The market-adjusted BHAR can be calculated as:

$$BHAR_{i,[r_1,r_2]} = \prod_{t=r_1}^{r_2} (1 + R_{i,t}) - \prod_{t=r_1}^{r_2} (1 + R_{m,t})$$

Here $R_{i,t}$ represents the company return for company i and t represents the trading day. Market returns is shown by $R_{m,t}$ for KSE 100 index on the day t .

Finally, the results of short term analysis as well as long term analyses will be compared so that affectivity of M&As deals can be analyzed for the banking sector of the country. The deals to be analyzed for the banking sector

The M&As deals for the banking sector are mentioned in the table below.

Table 1 Events under study

Event	Acquirer Bank	Target Bank	Event Date
E1	MCB Bank Ltd	NIB Bank Ltd	07/07/2017
E2	Meezan Bank Ltd	HSBC Oman (Pakistan operations)	30/09/2015
E3	Bank Islami Pakistan Ltd	KASB Bank Ltd	08/05/2015
E4	Meezan Bank Ltd	HSBC Bank Middle East Limited (Pakistan operations)	12/08/2014
E5	United Bank Ltd	Khushhali Bank Limited	11/05/2012

Source of data is Competition Commission of Pakistan and Pakistan Stock Exchange

4. DATA ANALYSIS

4.1. Short term Analysis

In the events study methodology, Abnormal Returns (ARs) and Cumulative Abnormal Returns (CARs) of the acquired firms are computed with the stock prices and market price

which are associated with the particular index. These ARs and CARs are effective for measuring the wealth effects on the shareholders' wealth before and after the occurrence of the particular event. The AR is the differences between the expected return and the actual return of the stock. While the CAR is the summation of all the ARs obtained in the event window[13]. For this study the event window has is 91 days in which 45 day pre and 45 days post performance and the announcement date has been analyzed. The estimation window for this study is 100 days which has been taken pre announcement of the event.

The below table shows the results of 5 events which are under study in the banking sector of Pakistan, in which pre performance, event date, post performance of firms and difference between pre and post performance is shown . On the announcement day of the event, the results indicate positive effects on ARs and CARs for the event 1, 2 and 4. The event 3 shows the negative abnormal return on the event day while its Cumulative Abnormal Return is positive on the event day. The event 5 show negative returns ARs and CARs for the banking sector after the announcement of M&As.

Besides, if we look at the differences between pre and post M&As performance. The ARs and CARs in the events 1, 3 and 5 are positive in the event window of 91 days, while the ARs and CARs for the event 2 is negative, for the event 4 it has positive ARs but negative CARs. The results explain that the three for the five events in the banking sector of Pakistan generated positive ARs and CARs.

This can be concluded that happening of M&As, positively affected the shareholders' wealth in the banking sector of Pakistan in Short term analysis. These results are matched with results of Flight[14], Soongswang[15] ,as they in their studies also reported positive returns by the occurrence of events. Though these results contradict with the results of Cummins and Weiss [16] , as they reported negative results after the announcement of M&As

Table 2 Abnormal Returns (ARs) and cumulative abnormal returns (CARs):

Event		Event Day	Pre-event	Post- Event	Difference
Event 1 (MCB Bank Ltd- NIB Bank Ltd)	Abnormal Return	0.10%	0.15%	0.20%	0.05%
	Cumulative Abnormal Return	6.80%	6.70%	8.81%	2.11%
Event 2 (Meezan Bank Ltd- HSBC Oman (Pakistan operations))	Abnormal Return	0.64%	0.45%	-0.43%	-0.87%
	Cumulative Abnormal Return	20.68%	20.04%	-19.29%	-39.33%
Event 3 (Bank Islami Pakistan Ltd- KASB Bank Ltd)	Average Abnormal Return	-2.77%	0.25%	0.36%	0.11%
	Cumulative Abnormal Return	8.62%	11.38%	16.17%	4.79%
Event 4 (Meezan Bank Ltd -HSBC Bank Middle East Limited (Pakistan operations))	Average Abnormal Return	2.65%	0.09%	0.03%	0.06%
	Cumulative Abnormal Return	6.77%	4.12%	1.28%	-2.84%
Event 5 (United Bank Ltd- Khushhali Bank Limited)	Average Abnormal Return	-3.03%	-0.24%	-0.08%	0.15%
	Cumulative Abnormal Return	-13.61%	-10.58%	-3.77%	6.81%

4.2. Long Term Analysis

The combination gain and to achieve synergy benefits is depend on the amalgamation process and this may require more times for firms to be effective[17]. So, to analyze the long run

effect of events we have extended this study by observing the long term effects on the stock prices. So, the author measured the performances of stocks for 90, 180, 270 and 360 days separately. This was measured after the announcement of deals using the Buy-and-Hold Abnormal Returns (BHAR) Approach. Below table shows the results of this long-term analyses using BHAR technique. We found that after 360 days the BHAR decreased by -23.82% and -6% for the event 2 and 5 respectively both events are insignificant at the 5% level. Further, for the event1, 3 and 4 BHAR increased by the 12%, 10%, and 3% respectively from these three events, the event 1 and 3 are highly significant at the 5% level and the event 4 is insignificant at the 5% level.

Table 3 BHAR for 90, 180, 270 and 360 days

Event		BHAR 90 days	BHAR180 days	BHAR 270 days	BHAR 360 days
Event 1 (MCB Bank Ltd- NIB Bank ltd)	Buy-and-Hold Abnormal Return	9%	7%	5%	12%
Event 2 (Meezan Bank Ltd- HSBC Oman (Pakistan operations))	Buy-and-Hold Abnormal Return	-10%	-35%	-15%	-23.82%
Event 3 (Bank Islami Pakistan Ltd- KASB Bank Ltd)	Buy-and-Hold Abnormal Return	4%	5%	17%	10%
Event 4 (Meezan Bank Ltd -HSBC Bank Middle East Limited (Pakistan operations))	Buy-and-Hold Abnormal Return	-2%	-9%	3%	3%
Event 5 (United Bank ltd- Khushhali Bank Limited)	Buy-and-Hold Abnormal Return	-15%	-7%	-20%	-6%

5. CONCLUSION AND RECOMMENDATIONS

Mergers and acquisitions trend in Pakistan can be traced back from 1998, from then and there numerous events occurred in Pakistan gradually every year. The same trend can be seen in the financial sector of Pakistan [18]. Synergy theory discuss that the companies go for M&As with an intention to growth, reduce costs, acquire assets and for the expansion of business in new markets to improve profitability and to enhance wealth of shareholders[19].

The purpose of this paper was to analyze the performance of banking sector firms of Pakistan in terms of shareholders' wealth after the occurrence of M&As. This was done in two ways; first, short term performance was analyzed with the help of event study method to interpret abnormal returns after the M&As. Secondly, Long term performance was analyzed with the help of BHAR, as per different authors, such events of M&As take a longer time to mature. This study show that the M&As occurrence in banking sector had significant and positive impact on the shareholders' wealth so this can be concluded for the banking sector of Pakistan that it has potential to achieve synergistic gain, improving the returns and performance of firms. This study suggests that, various other studies can be conducted to analyze the financial stability of various sectors by using accounting method so that financial

ratios can be analyzed and managerial perspective can be analyzed as well in various sectors of the country.

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