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Analysis of M&A in the Indian Pharma and their Stock Price

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ABSTRACT

This paper is to examine the impact that the announcement of a merger and acquisition on the stock prices of such company. The focus of this paper has been narrowed down to companies in the Indian Pharmaceutical Industry. This paper focuses upon 3 key deals; Sunpharma and Ranbaxy, Unichem and Torrent and Piramal and Abbot. To conduct this study, the Market study model was used taking a 61 day time period; 30 days before and 30 days after the announcement of such merger and acquisition.

1. Introduction

Any company can achieve growth through two different means; internal (organic) or external (inorganic).Internal growth is comparatively more difficult to achieve than external growth. However, internal growth means that the organization is more in control of the operations and the business. When any organization wants to grow, there needs to be a decision in regards to whether they would want to pursue internal, external or a hybrid of both types of growth. The pharmaceutical industry has a highly competitive landscape and there is high pressure in terms of drug manufacturing, research and development as well as regulatory aspects. Recent trends have shown that growth for such companies is limited in scale due to numerous factors ranging from generic drug products to a decline in the subscription of branded drugs as well as the fact that the governments in Europe and North America are reducing their budgets towards healthcare. As a result, a frequently type of growth within the pharmaceutical industry involves mergers and acquisition. A key difference amongst a merger and an acquisition is that an acquisition involves one company buying and taking over the other whereas a merger is when the two companies join hands together and combine to form one. It is important to have adequate finances in order to be able to complete an acquisition. Both are forms of external growth which allow the pharmaceutical company to be able to adequately respond to the highly competitive landscape in a quicker fashion than that which would have occurred had they chosen an internal form of growth.

Hence, even though mergers and acquisitions do cause issues for the merged company due to interference with current research and development and other activities, the benefits of such surpass the interferences. This is due to the mere fact that they are of utmost importance in terms of both short term survival and even towards the long term survival and competitiveness. This has been proven through deep examination which has led to many facts being established such as the merged company sees a rise in profits of approximately 50% for 2 years following the mergers. In addition to this, it has been established that the merger increases the share of revenue by 40% towards the existing product portfolios as well as 20% towards new product portfolios. Therefore, there has been an enormous rise in the mergers and acquisitions conducted by pharmaceutical companies in India. It is also said that such mergers and acquisitions do aid in increasing the shareholders overall value. Hence, it is prudent to study the short term impact that such a merger and acquisition can have towards the stock prices of a pharmaceutical companies.

2. Review of Literature

a) This paper focuses upon the impact that mergers and acquisitions have upon the stock prices in the US ethanol-based bio-fuel industry. This study utilizes an event analysis method to examine upon the same choosing 30 days pre and 30 days post the announcement dates. Through this, the study found that the capital markets do respond to merger and acquisition announcements in the US ethanol based bio-fuel industry. It was found that there were considerable increases in the market value in the short term. (Khanal& Mishra, 2013)

b) Chun-Pin and Flouris focused on the effect that European mergers and acquisitions have on their stock prices as well as their trading volumes. It examines 3 major mergers; Iberia-British Airways, Air France-KLM and Lufthansa. The empirical results revealed that investors were in favor of such mergers as the stock prices increased as well as an improvement seen in the stock returns. The study used the Garch-EVT Copula model for further examination. This further proved that the mergers had positive effects for investors in most of the cases. (Chun-Pin &Flouris, 2016)

c) The paper studies the effect of mergers and acquisitions in the banking industry in Pakistan and their effect on the stock prices. Through the event analysis method, the paper concluded that most indicated a negative return and that it could be seen that there was an overall negative response in the market towards the announcement of such mergers and acquisitions. It is important to note that there were 57 mergers which occurred in the banking industry in Pakistan between the years 2002 to 2012 and that this study focused upon 11 such mergers. (Rehman& Ali, 2017)

d) This report evaluates upon the effect on performance of an entity through mergers and acquisitions. It deals with firms located in emerging markets, more specifically on Chinese pharmaceutical companies. This study thoroughly researches upon this through partial least squares regression. Through this, it was seen that there is a positive correlation between an entities' performance and mergers and acquisitions. Therefore, it was seen that Chinese pharmaceutical firms which are at their growth stage can improve their performance through mergers and acquisitions. (Zhang and Wang, 2018)

e) Liu and Chen's paper focuses upon the effect that a merger and acquisition has on the long term performance of a company. The paper delved into mergers and acquisitions occurring in Taiwan between the years 2005-2013. The study was able to conclude that there is a positive relationship and thorough examination was done through a regression analysis using OLS estimates. (Liu and Chen, 2017)

f) This paper focuses upon examining the stock market reaction towards a merger and acquisition and whether the stock market reaction is able to capture the post-merger profitability of the company. An event study method was used for conducting this research where the focus was upon the Scholes-Williams method. This paper was able to reach the conclusion that the event study method is a useful mechanism for analyzing the post-merger profitability. (Duso and Gugler, 2010)

g) This study is focused upon testing the ability of the stock market prices to the 'Granger cause' merger activity. The Granger causality test is implemented to analyze whether one time series can be used to forecast another time series. The study examined quarterly data of the UK Stock market for the period 1969 to 1994. The results of this research led to the conclusion that stock market returns Granger cause mergers. (Clarke and Ioannidis, 1996)

h) Aharon and Gavious' evaluated the impact of stock market bubbles on mergers and acquisitions. For analysing this, they used a broad sample from the US markets between the years 1993 and 2005. It also focuses upon the technology bubble which was witnessed in the 1990s. The time periods were divided into 4 different periods and involved 3 major sectors; high technology, low technology (manufacturing) and trading and services. The conclusion formed by them was that there was an increase in mergers and acquisition activity during the bubble which reduced once the bubble was burst. This reduction continued to happen even after such bubble was burst due to cautious nature of the investors. (Aharon and Gavious, 2010)

i) This study focuses upon mergers in the pharmaceutical industry and the effect such has on the research and development activities. The conclusion that this study reached was that there are serious doubts over whether mergers produce important innovation advances and lead to significant increases in the research productivity. Hence, there is no solid evidence to say that mergers and acquisitions in the pharmaceutical industry lead to increase in research productivity and also there is no evidence to say that these mergers increase or reduce the incentives for other pharmaceutical companies to innovate.(Ornaghi, 2008)

3. Research Design

Research Objectives

This research has been conducted in order to study the effect of the announcements of merger acquisitions on the stock prices of the Indian Pharmaceutical Companies. The following is the specific objective: To analyze the impact of a merger and acquisition on the stock prices in the pharmaceutical industry.

Sources of Data

The main source of gathering the data has been secondary. Various web sources have been used for procuring information related to the stock prices of the companies alongside the press releases of the announcement of the merger and acquisition deals.

Limitations

Due to the fact that most of the data is from secondary sources, there is no complete reliability on these web sources. In addition to this, in certain cases, there may have been prior knowledge of the merger and acquisition before an official announcement which would mean the impact of such announcement would be limited.

Methodology

This paper is focused upon the mergers and acquisitions which occurred in the Indian pharmaceutical industry during the last 10 years. In 2016 alone, there were 54 mergers and acquisitions which took place in the Indian pharmaceutical industry. This is due to the fact that the Indian pharmaceutical industry is highly competitive. This study will be focusing upon 3 such events (Ranbaxy &Sunpharma, Torrent &Unichem and Abbot Healthcare &Piramal).

To be able to analyze the impact of the events on the stock prices of the involved companies, the Market Study Method was implemented. The Market Study Method involves is known to be the standard method for evaluating the impact that a sample event may have. This involves examining the returns of the stocks by using the data in relation to stock prices.

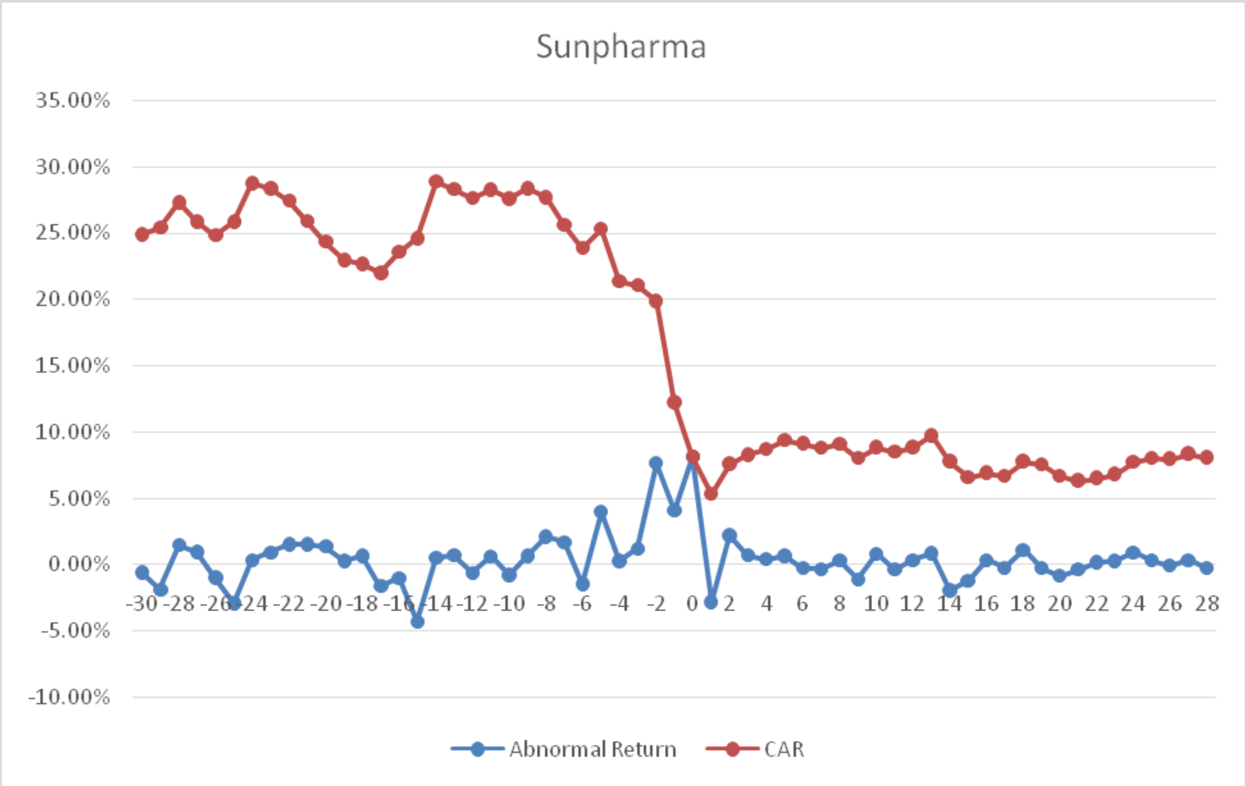
To be able to do so, the abnormal returns as well as the cumulative returns were examined upon. Abnormal returns helps to measure the market reaction. Abnormal returns is the difference between the cumulative returns and the expected returns. Cumulative returns are the summation of the abnormal returns. Both, abnormal and cumulative returns analyze the effect that the event (in this case, merger or acquisition) has on the stock prices of the relevant companies.

To be able to carry out a Market Study Method, it is important to understand the concept of Event Day as well as Event Day Estimation. Event day is the day on which such merger and acquisition is being announced by the relevant company. It is of high importance for evaluating the impact of the event. For example, if it observed that there are high abnormal returns before the event day then it is likely that information regarding such merger and acquisition has been leaked to the market. Hence, it is of utmost importance to collect information from the market which is accurate.

The event window is known to be the period of time which is analyzed to measure the abnormal and cumulative returns. The event windows are known to differ in different studies. In this study, we have analyzed the impact of the event on a 61 day basis (30 days before the event, the event date and 30 days after the event).

4. Analysis

Figure 1: Abnormal and Cumulative Abnormal Returns of Event 1 of both Ranbaxy and Sunpharma



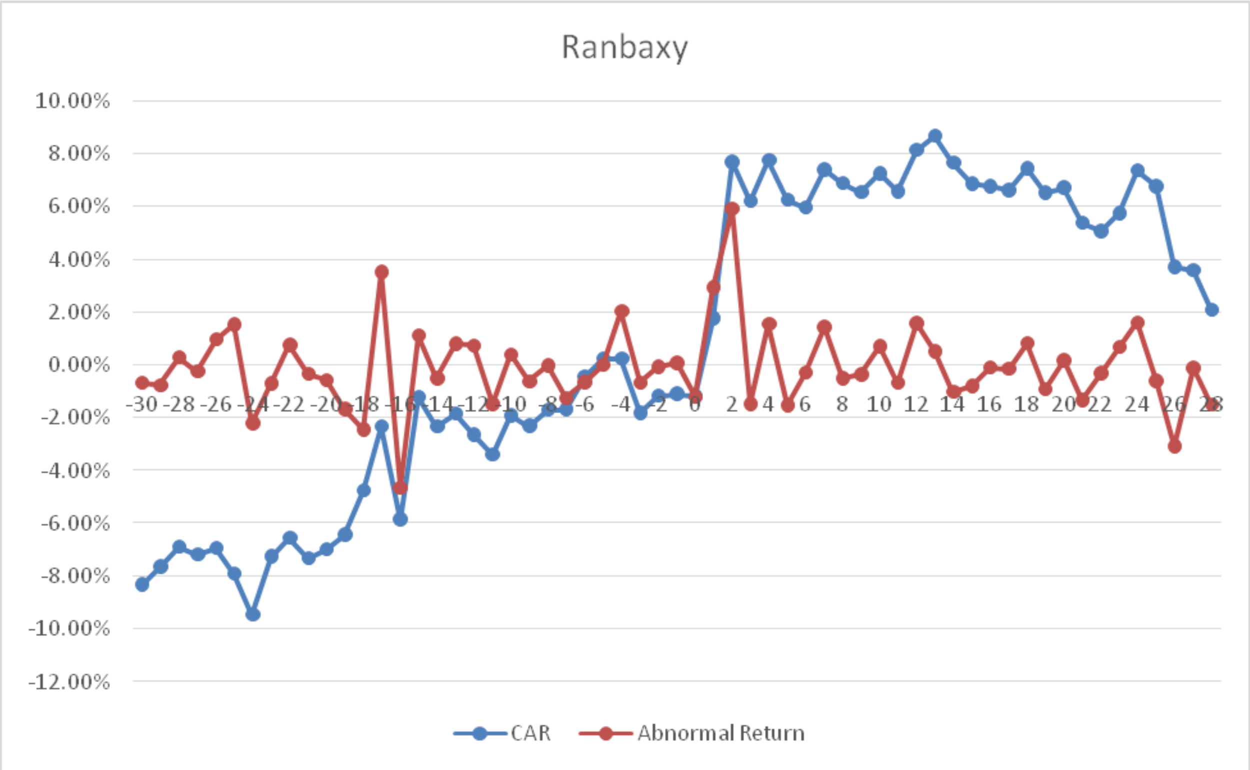
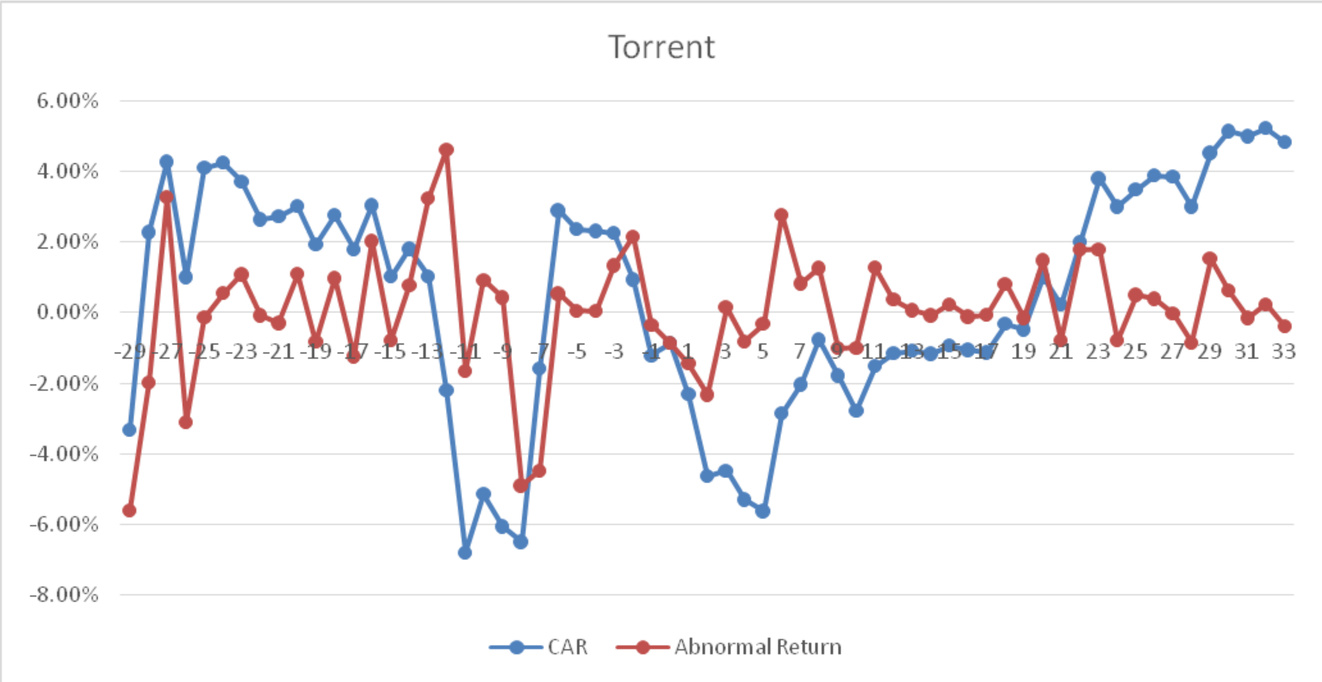


Figure 2: Abnormal and Cumulative Abnormal Returns of Event 1 of both Unichem and Torrent



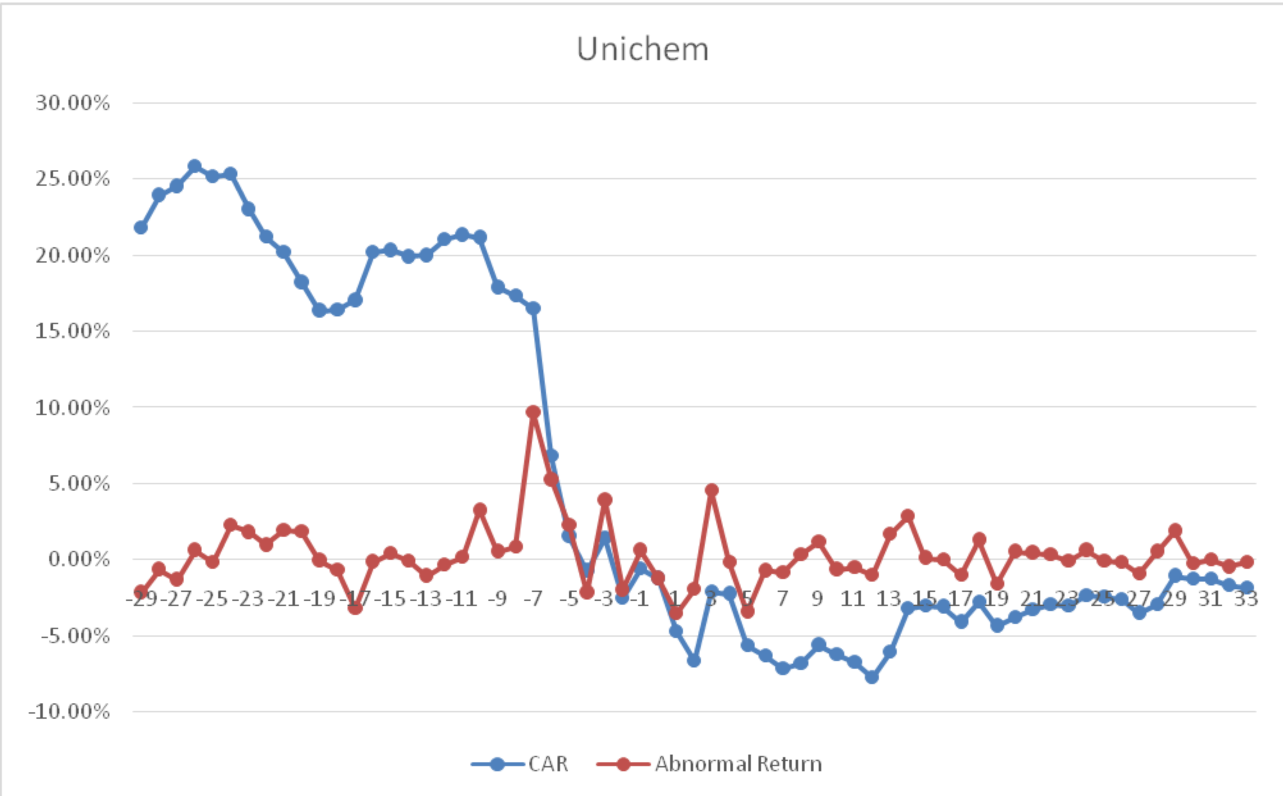
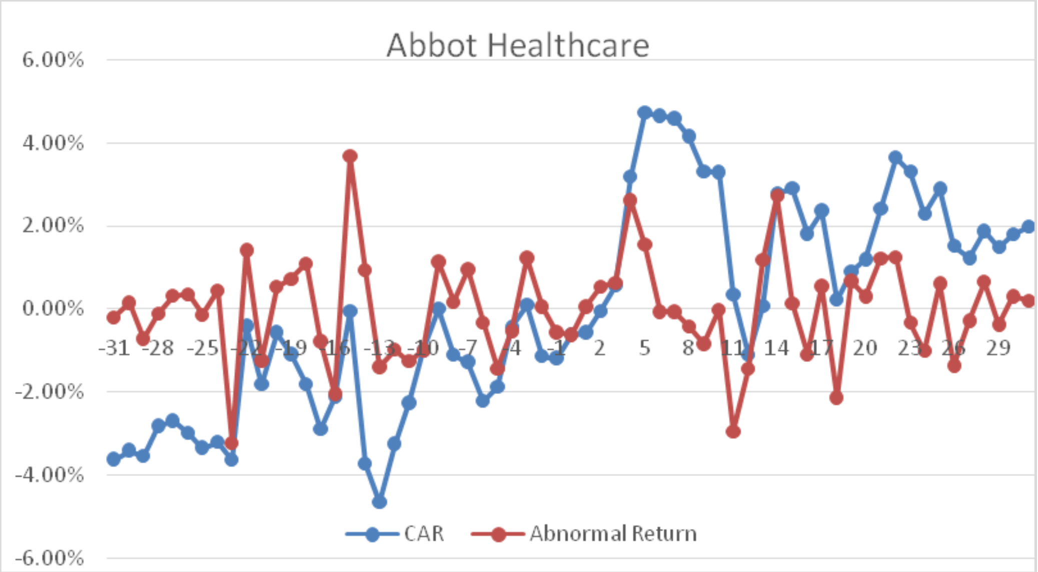
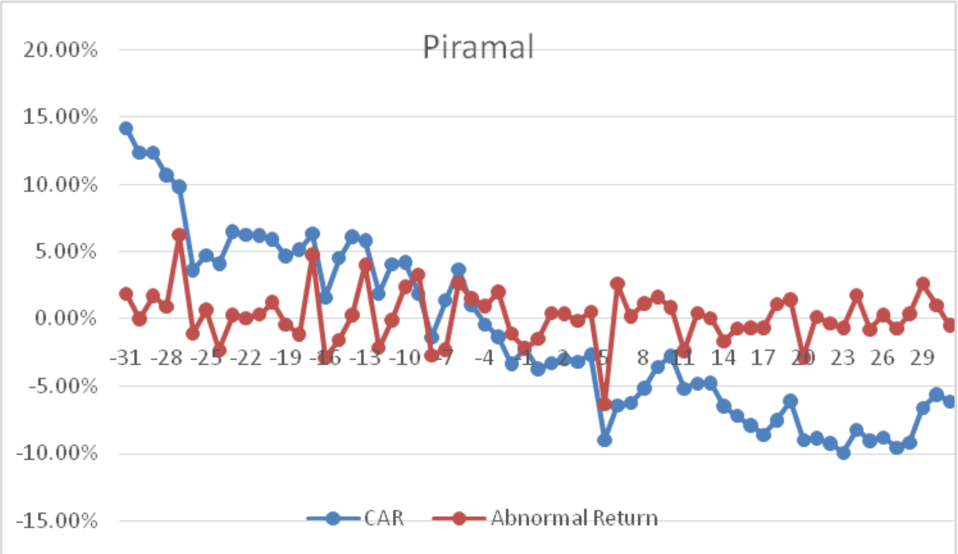


Figure 3: Abnormal and Cumulative Abnormal Returns of Event 1 of both Piramal and Abbot





When analyzing the above graphs, a pattern can be observed. This pattern is that the Cumulative abnormal returns of the purchasing pharmaceutical companies (Sunpharma, Torrent and Abbot Healthcare) are positive by the 30th day after the announcement of such merger. In events 2 & 3, it can be duly noticed that initially the Cumulative abnormal returns are in the negative and later arrive at a positive figure. In terms of just abnormal returns, it can be seen that it is highly positive in the first few days after such announcement and from there, fluctuations can be noticed. Whilst some of these fluctuations cause the abnormal return to be negative, it remains positive on a majority basis.

The pattern for the company which is being purchased (Ranbaxy, Unichem and Piramal) is in stark contrast to the patterns noticed above. It can be seen that post announcement, the abnormal returns are fluctuating but this happens majorly on a negative basis. As a result of which, the Cumulative abnormal return continues to fall and fall until it too becomes negative. All 3 of these companies had positive cumulative abnormal returns before the announcement of their acquisition but after such announcement, this situation was completely overturned.

5. Conclusion

Therefore, to conclude, we can see that the announcement of the acquisition has a negative impact on the cumulative abnormal returns of the pharmaceutical company which is being acquired. Whereas, the acquiring company is able to witness a high growth in their cumulative abnormal returns 30 days after the date of such announcement.

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