The Impact of M&A on Performance of Firms in The Luxury Goods Industry

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Abstract: This study focuses on the recent M&A activities in luxury industry. The interest of investors in the industry has never been greater than ever, and there has been a remarkable consolidation not long ago. From 2007 to 2017, top 30 luxury companies in the luxury industry made 31 major acquisitions, and an event study is conducted to test this hypothesis. Acquirers have indeed achieved significant positive abnormal returns on the anniversary. However, in the long window period, the acquirers tend to perform below the expected return, contrary to the short-term performance.
Keywords: M&A; Abnormal Returns; Luxury Goods Industry

Introduction

Mergers and acquisitions are a common phenomenon in all industrialized countries and, more especially, in developed countries [4]. These deals related to the main decisions of the parties involve: strategy, operations and finance. The ultimate goal is to create value and only when the combined value of the two companies is greater than the separated value, can value be created.

1. Mergers & acquisitions

1.1 Definition and concept of M&A

M&A, short for "merger and acquisition", is a term used to describe a large number of transactions. It usually refers to the ultimate beneficial ownership and any process by which control of a company is transferred from one subject to another.Although the terms are often used confusedly, the terms M&A are very ambiguous. In fact, in practice, their use is often unclear. But, strictly speaking, their terminology is different. It is defined that an acquisition as one firm purchasing another one, and a merger as the combining of the assets of two equal-sized firms.

1.2 Classification of M&A

There are various different categories of M&A activities. However, in this chapter, three major classification that are used by researchers, namely horizontal merger, vertical merger and conglomerate merger.

(1) Horizontal merger .It refers to the combination of two competing firms that are producing or selling the same or similar products . The aim of the horizontal M&A is to eliminate the competition, expand market shares and increase the monopoly power. Generally, horizontal merger occurs more often in the industry that just go through the high-speed growth period and into the stable development period.

(2) Vertical merger .It refers to the combination of two companies at different steps of the production process: between firms and their suppliers or customers. The aim of vertical M&A is to strengthen the control for the production and intermediate links in order to better control the cost and quality.

(3) Conglomerate merger .It refers to the combination of two companies that are not related to each other and have no common business areas. When facing the fierce competition, in order to be more competitive, enterprises from all walks of life are attempting to achieve diversification through the merger of diversified enterprise groups.

2. Luxury goods industry

Over the last two decades, the industry for luxury goods has experienced spectacular growth. For more than a generation, the luxury industry seemed impervious to economic change. In recent years, this trend has been proved wrong. Since 2017, many luxury goods brands have struggled to survive as the stock market has soared and household economies have stabilized.

As described earlier, the luxury industry offers exclusivity to its customers. As a result, if too many luxuries are sold in the market, the luxury goods industry will no longer be a profitable market, and the product loses its value at the customers' eye. This is the reason why the luxury industry has to strike a balance between the number of sales and the image of the luxury brand. As a result, small quantity of sales is compensated by high prices.Compared with the non-luxury goods industry, the luxury goods industry is very distinctive in three aspects: firm size, financial position and relationship to time.

3. Results & Findings

This third section is intended to analyze M&A Deals Sample. Based on this sample, the hypothesis dressed in the previous part of this paper is tested.

3.1 Data analysis

This article selects 31 transactions for the analysis.

2017 is the year with the largest number of M&A transactions [6], making up about 20% of the sample. There are also two periods of declining in M&A activities, 2008-2009 and 2013-2014, respectively. Both happened after the economic crisis when European economic slowdown, namely the subprime crisis in 2007-2008 and the European sovereign debt crisis continued until 2012-2013.

The most active acquirers have been LVMH, L'Oréal Luxe and Coty Luxury with respectively five (16%), four (13%) and four (13%) acquisitions. In total, European acquirers executed 55% of the transactions accounting for 50% of the value. The total deals' value amounts to EUR 43318.61 million. Coty Luxury accounted for 27% of it, LVMH for 26%, PVH Corp. for 11%, and L'Oréal Luxe for 9%. The biggest deal was the Galleria Co acquisition by Coty Luxury; it is worth EUR 11360.54 million and represents almost 1/3 of the total deals'value.

3.2 Findings

3.2.1 Short-term abnormal returns

All test results are statistically significant. And, as expected, they are quite high. The average and median values of beta are 1.01 and 0.91, respectively, which are reasonable to be close to or lower than 1, as luxury goods are usually classified as non-cyclical goods. However, the values of beta vary greatly in the samples, with the maximum value of 1.581 and the minimum value of 0.549.

The distribution of R-squared is similar to that of beta (as shown in Table 1). The goodness of fit in terms of the average and median values are close, 24.603% and 20.7%, respectively. Both statistical significance and goodness of fit seem to be positively correlated with market value, demonstrating that the market model may not be sufficient to capture the systemic risk of small and less traded stocks.

Table 1: Short-term market model regression results (source: Author)

	Average	Median	Max	Min
AR0	1.895%	2.332%	4.379%	-1.461%
ST	1.011	0.937	1.581	0.525
T-stat	13.843	12.860	23.917	7.271
ST	0.166%	0.138%	0.838%	-0.637%
T-stat	0.497	1	2	-1.691
R2	24.603%	20.7%	1	1.9%
CAR(-2;+2)	0.057%	-0.827%	4.886%	-2.333%
CAR(-10;+10)	-0.342%	0.066%	14.875%	-13.793%

The results of test statistics are shown in Table 2:

Days	-10;-1	-5;-1	0	-2;+2	-5;+5	-10;+10	+1;+5	+1;+10
Average Return	-0.043%	0.078%	0.656%	2.568%	1.409%	1.942%	1.134%	0.648%
tCSS	-0.069	0.399	2.951**	3.466***	1.551*	1.463*	0.92	0.813
tCDA	-0.061	0.194	3.568**	3.739***	1.459*	1.496*	1.63	0.788

Table 2: Statistical significance of short-term abnormal returns (source: Author)

*** = significant at 1%, ** = significant at 5%, * = significant at 10%

The (- 5, + 5) event window is still significant at 5% level with a cumulative return of 1.409%. In addition, the results of the (- 10, + 10) window are significant for both test statistics, but only at the 10% level. Using cross-sectional tests, the 5-day window after the event was not significant, while using the t-statistic with coarse dependent adjustment, the results are significant at the 10% level. This shows that abnormal returns are not only realized on Day 0, but may also occur in the next few days.

The long period of 10 days after the event proves that the cumulative average abnormal return is not less than zero. This is consistent with the assumption of market efficiency. It can be seen from the data that when the event is announced, the market react positively, and new information is quickly incorporated into the stock price. At the same time, the 5-day and 10-day pre event windows are also tested to determine whether the market expects the trading announcement. It can be seen that the cumulative average return before the event date is close to zero, and the difference is not significant.

3.2.2 Long-term abnormal returns

After analyzing the short-term excess returns, it is time to discuss long-term returns. The estimated period is like this, ranging from 249 to 31 days before the announcement date. In addition, the methodology remains unchanged and the change is only the forecast period. This time the expected normal return is forecast for one year and two years period. To be more specific, one year is equal to 250 trading days after trading, and two years is equal to 100 trading days after transaction.

Beta estimates have the same variation, but slightly higher than the slope of the market index regression. This is completely reasonable and expected, because this time, we get not the systemic risk of the stock, but the risk stocks which are relatively exposed to their industry. As a result, the risk is expected to be quite closer to 1, so most beta values are very close to 1, with a median of 1.011

The goodness of fit of median data and max data in the long-term are significantly improved compared with those in the short-run, from 20.7% to 28.6%, from 1 to 145.3%, respectively. Nevertheless, this does not mean that the goodness of fit of benchmark is better. Most transactions are carried out by large companies, which have a large weight in the reference index, and they are regressed against. It is natural that R-squared is higher than before because the company's earnings will affect the benchmark's earnings.

4. Conclusions

Nowadays M&A occur more and more frequent and an increasing number of companies have already realized its importance especially some companies from fast-growing industries like luxury goods industry. Because of the fierce competitions in these fast-growing industries, enterprises attempted to expand themselves for competitiveness enhancement. As a result, M&A is then regarded as one of the most efficient strategies for companies' development.

Mergers and acquisitions are an important way for firms to develop and survive in the fiercely competitive environment nowadays. As we have discussed in the literature review part, there are many motives for firms to participate in M&A activities. Through mergers and acquisitions, companies may generate synergy, gain more market power, achieve better resource allocation and improve efficiency. This is the value-creation aspect of M&As which will improve the general performance of firms.

The purpose of this study is to identify whether the acquiring firm stock price is affected by the M&A announcement during the period from 2007-2017. Based on the selection criteria, the final sample consists of 31 M&A deals. This study uses event study methodology to investigate the effect of M&A announcement on the acquiring firms' performance both in the short-run and long-term.

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