Post-Merger Performance of Acquiring Firms across Industries in India: A Case Study

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Abstract

Mergers and Acquisitions (M&A) have gained substantial importance in recent times as a significant toll for corporate restructuring and thus creating value for the entities. It enables the firms to explore new markets, expand their horizons, reducing the business risks, and geographical areas thereby increasing the profits and gaining through competitive advantage. The present research paper aims at studying the impact of mergers on the financial performance of Indian corporate entities from different sectors like banking, pharmaceutical and steel by examining various financial ratios of the sample of companies listed on the BSE from the period 2000-2010. For the purpose of analysis paired sample t-test is conducted. The results suggested that there was positive impact seen in the banking sector which has sustained also upto (t+5) in the given profitability variables whereas in case of pharma and steel sector not much impact is seen on the profitability. There is improvement in net profit margin in pharma and return on assets ratio in the steel sector in (t+1 year window). The results reported in the study points to the positive impact of merger announcement on the financial performance in majorly in the short run (+1 yr).

Keywords: Merger & Acquisitions, financial ratios, financial performance

1.0 Introduction

The rapid changing technologies, fast moving economies, the positive impact of globalization, accelerated revenues has triggered the activity of M&A in India and increased manifold in recent times. Mergers and acquisitions have always been taken as the one of the most convenient and profitable strategy to survive in the competitive environment. The intent is to gain competitive advantage, capitalizing larger market share, creating profits through synergistic effect and economies of scale thereby bringing competencies and capabilities for a sustainable corporate performance.

1.1 Mergers and Acquisitions in Indian Industry.

The Indian companies have understood well the significance of environmental adoptions, technological innovations and competitive advantage. Post economic liberalization in early
1990’s Indian economy has undergone a massive transformation. The Indian companies have understood well the significance of environmental adoptions, technological innovations and competitive advantage. The economic reforms gave enabled the corporate to introduce various structural changes and restructuring activities mainly followed by merger and acquisition deals.

Statistics have shown the increasing trend of M&A activity in recent times. In 2014 mergers and acquisition deals amounting to $16 bn took place in which banking and pharmaceutical sector dominated the deals. A total of 253 deals took place majority leading to mergers and acquisitions in pharma and banking sector followed by energy and natural resources. Figure 1 shows the statistics generated by grant thornton on mergers and acquisitions activities took place in India in 2014.

Fig.1 Domestic M&A round up in 2014

(Source: Grant Thornton Annual Dealtracker Report, 2014)
2.0 Review of Literature

Various studies have concluded and resulted an optimistic affect of mergers on corporate performance of the company. By adopting certain parameters of measuring the financial and operative improvements in the companies researches have concluded that mergers have favorable impact on corporate.

Kruze, Park and Suzuki (2003) studied the long term operating performance of mergers of Japanese companies with a sample of 56 mergers of manufacturing companies from the period 1969 to 1997. The cash flow performance in the five year period following mergers were studied .it found evidence of improvement in operating performance and also pre and post merger performance are highly correlated. It concluded that long term operating performance of control firms was positive but insignificant and high correlation existed between pre and post merger performance.

Vanitha.S and Selvam. M (2007) in their study “Financial Performance of Indian Manufacturing Companies During Pre and Post Merger” analyzed 17 companies as a sample out of 58 to study the impact of merger on the performance in Indian manufacturing sector from 2000- 2002. For financial performance analysis ratio analysis, mean, standard deviation and “t” test was used. The found overall financial performance to be insignificant for 13 variables.

Pramod Mantravadi and Vidyadhar Reddy (2008) investigated a sample of 118 cases of mergers in their study, “Post merger Performance of acquiring firms from different industries in India” aimed to study the impact of Mergers on operating performance of acquiring corporates in different industries from a period of 1999 to 2003. The results showed minor variation in the operating performance following mergers where more impact of merger was noticed on the profitability of banking and finance industry, pharmaceutical, textile and electric equipment sector whereas significant decline was seen in chemical and Agri-Products sector.

Beena (2004) analyzed the pre and post merger performance of firms belonging to manufacturing industries with an investigation of sample of 115 acquiring firms between the period 1995-2000. For the purpose of analysis four sets of financial ratios were considered and it was tested using t –test. The study showed no improvement in the performance in comparison to the pre merger period for sample companies.

Ghosh and Jain (2000) analyzed whether the merging firms increase their financial leverage after merger. For this a sample of 239 mergers during 1978 to 1987 in the US taken. The result showed that mean financial leverage resulted in 17% increase as compared to pre merger financial leverage of combined firms. The study was conducted on comparing pre and post merger performance on the case to case basis.
Likewise Healy, Palepu, and Ruback (1992) studied the post-acquisition performance for 50 largest U.S. Mergers took place in the time period of 1979 and 1984 by measuring cash flow performance the results showed that operating performance of merging firms improved significantly following acquisitions. On the other hand Ghosh (2001) investigated whether operating cash flow performance improves following corporate acquisitions, using a design that accounted for superior pre-acquisition performance, and found that merging firms did not show evidence of improvements in the operating performance following acquisitions.

Antony A. (2011) in his study, “post merger profitability of selected banks in India” took a sample of 6 banks 3 public sector and 3 private sector banks respectively for a period of 1999 to 2011. He examined the impact of mergers by using certain profitability ratio like growth of total assets, net profit ratio, return on assets, return on equity, net interest margin ratio using paired t-test. The results showed a significant difference in the profitability of banks post merger.

Mergers and acquisitions have shown constructive effects on the financial position of the company which was supported by another research conducted by Dutta and Dawn (2012) which was based on Indian banks mergers post liberalization period. In their study “mergers and acquisitions in Indian banks after liberalization: An analysis” four years pre and post merger performance of the banks were evaluated on the basis of growth of assets, profits, revenue, deposits and no. of employees. The results showed a significant improvement in the performance.

Weston and Mansingka (1971) studied the performance of conglomerate firms pre and post merger period. The results showed that earnings rates significantly underperformed those in the control sample group, but after 10 years, there were no significant differences observed in performance between the two groups.

Surjit Kaur (2002) in her study compared the pre and post-takeover performance during 1997-2000 for a sample of 20 acquiring companies, with a set of eight financial ratios, during a 3-year period before and after merger. T-test was used for the purpose of analysis. The study concluded that both profitability and efficiency of targeted companies declined in post-takeover period. Similarly Pawaskar (2001) investigated the pre and post merger performance of 36 firms from 1992-95, using various financial ratios like profitability, growth, leverage and found that the acquiring firms performed better than industry average in terms of profitability. For analysis regression was conducted and it was observed that there was no increase in the post merger profits to main competitors of acquiring firms.

Danzon et al. (2007) studied that in large pharmaceutical and biotech firms mergers are motivated by excess capacity, provides for
restructuring of asset base. Also it was observed if smaller firms actively participate in mergers they would achieve more due to economies of scale as compared to larger firms.

3. Study Methodology

3.1 Objectives of the study

The present research paper aims at analyzing the impact of mergers on the performance of companies in the Indian banking, pharmaceutical and steel sector with the following objectives:

- To study the impact of merger announcement on the financial performance of the acquiring firms in the post merger period.
- Further, the study intends to investigate the sustainability of post merger performance in the +1, +3 and +5 year window.

3.2 Research Hypothesis

To test the objectives stated above the following hypotheses were formulated:

H01 - There is no significant difference in the financial performance of the acquiring firms post merger period.

3.3 Sample Selection:

The present study takes into account the Mergers in pharmaceutical, banking and steel sector announced between January 2000 to December 2010 by the companies listed on Bombay stock exchange. Only stock to stock mergers were considered in the sample. Merger cases where 5 years post merger and 1 year pre merger data were not available have been excluded from the sample. Banks, pharmaceutical and steel sector has been taken in the sample. In banks only PSU’s mergers have been considered. All the companies merged in the same industry were included. Hence the sample size of study comes out to be 28 mergers in the recent study period.

<table>
<thead>
<tr>
<th>Industry (Acquiring Company)</th>
<th>No. of mergers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>08</td>
</tr>
<tr>
<td>Pharmaceutical</td>
<td>14</td>
</tr>
<tr>
<td>Steel</td>
<td>06</td>
</tr>
<tr>
<td>Total</td>
<td>28</td>
</tr>
</tbody>
</table>

4. Data Collection and Analysis

4.1 Data Collection

Secondary sources have been used for data collection of various financial ratios for 1 year pre upto post 5 years of merger of the sample companies. The data was obtained from Prowess database of Centre for Monitoring Indian Economy (CMIE) and website of the Bombay Stock Exchange (BSE). The announce dates and year of mergers of the sample firms was also verified from the BSE website.

4.2 Data Analysis:

For the purpose of measuring the financial performance of the merger the following ratios have been considered to evaluate the impact of mergers.

Financial performance Indicators

1. Net Profit Margin
2. Return on capital employed
3. Return on net worth
4. Earning Per Share
5. Return on assets excluding depreciation

The year of announcement is taken as the base year and denoted as “0”. The year before the
merger is denoted as (-1), post 1 year as (+1), post 3 years (+3) and post 5 years as (+5) respectively. To determine the impact on performance in the pre and post merger period, paired sample T test has been conducted at the confidence level of 0.05. The 1 year pre merger financial ratios are compared with post 1, 3 and 5 years financial ratios in subsequent pairs of (-1, +1), (-1,+3) and (-1,+5) respectively.

5. Results:
5.1 Analysis of financial performance of acquiring firms in different industries

i. Pharmaceutical

Table 1: Paired sample t-test of various financial ratios pre and post mergers

<table>
<thead>
<tr>
<th>Financial performance indicators</th>
<th>Mean values(pre and post mergers)</th>
<th>t-value(paired sample pre and post)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-1</td>
<td>+1</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>12.257</td>
<td>17.108</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-2.336*</td>
</tr>
<tr>
<td>Return on capital employed</td>
<td>22.993</td>
<td>31.302</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-2.142</td>
</tr>
<tr>
<td>Return on net worth</td>
<td>22.615</td>
<td>31.126</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-1.391</td>
</tr>
<tr>
<td>Return on assets excluding</td>
<td>73.763</td>
<td>75.263</td>
</tr>
<tr>
<td>revaluations</td>
<td></td>
<td>-0.151</td>
</tr>
<tr>
<td>Earning Per share</td>
<td>21.920</td>
<td>32.742</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-1.163</td>
</tr>
</tbody>
</table>

Values in [ ] denotes significance t values.
*denotes significant at 0.05

**Interpretation:** In table 1 the comparison of various pairs of pre and post ratios in the sample shows that significance difference can be seen only in net profit margin ratio where it is depicted that post 1 year and post 3 yr of mergers the impact on the net profit is positive. Rest of the ratios shows no significant impact post merger. The mean values have also

ii. Steel
Table 2: Paired sample t-test of various financial ratios pre and post mergers

<table>
<thead>
<tr>
<th>Financial performance indicators</th>
<th>Mean values (pre and post mergers)</th>
<th>t-value (paired sample pre and post)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-1</td>
<td>+1</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>8.101</td>
<td>5.798</td>
</tr>
<tr>
<td>Return on capital employed</td>
<td>18.473</td>
<td>11.836</td>
</tr>
<tr>
<td>Return on net worth</td>
<td>18.105</td>
<td>13.436</td>
</tr>
<tr>
<td>Return on assets excluding</td>
<td>123.45</td>
<td>170.55</td>
</tr>
<tr>
<td>revaluations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earning Per share</td>
<td>29.633</td>
<td>15.031</td>
</tr>
</tbody>
</table>

Values in [ ] denotes significance t values.

*denotes significant at 0.05

**Interpretation:**

In table 2 the comparison of various pairs depict that significant difference is observed in return on assets ratio in +1 window t-value being 1.147 ( p value= 0.045< 0.05) which is significant in the observation whereas no impact can be seen in other financial indicators. There is increase in the mean values of return to assets ratio which can not be observed in other ratios.

### iii. Banks

Table 3: Paired sample t-test of various financial ratios pre and post mergers

<table>
<thead>
<tr>
<th>Financial performance indicators</th>
<th>Mean values (pre and post mergers)</th>
<th>t-value (paired sample pre and post)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-1</td>
<td>+1</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>8.452</td>
<td>13.156</td>
</tr>
<tr>
<td>Return on capital employed</td>
<td>10.540</td>
<td>9.528</td>
</tr>
<tr>
<td>Return on net worth</td>
<td>16.423</td>
<td>24.568</td>
</tr>
<tr>
<td>Return on assets excluding</td>
<td>69.176</td>
<td>103.21</td>
</tr>
<tr>
<td>revaluations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earning Per share</td>
<td>9.503</td>
<td>18.531</td>
</tr>
</tbody>
</table>

Values in [ ] denotes significance t values.

*denotes significant at 0.05
Interpretation:
In table 3 the net profit margin ratio, return on assets ratio and earning per share depicts significant improvement in the performance post merger. However net profit margin shows improvement only in +1 window with t-value being -3.13(p=0.011<0.05) whereas return on assets excluding depreciation shows a continuous improvement post merger in +1,+3,+5 window. Earning per share doesn’t show an improvement initially but post 5 years it shows an improvement with t-value -3.231(p=0.014<0.05).

6. Conclusion:
Through the study it was observed that merger have significant impact on the performance as compared to pre merger period but the impact is evident more in the immediate year after merger. Though in case of banks sustained impact was observed upto t+5 window. The findings revealed that profitability has improved as indicated by ratios like ROA, EPS and Net profit margin but the improvement in the performance is observed only upto 1 year of merger that too not in all the profitability variables indicated. Likewise the sustainability of post merger performance has conspicuously absent in this regard too in the post merger (+3,+5) period exception to this is banking mergers that have been studied. This improvement has not sustained in post merger announcement (+3, +5 year) period. Therefore the results reported in the study points to the positive impact of merger announcement on the financial performance majorly in short run (+1 yr).

References:


