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IMPACT OF MERGER ON FINANCIAL PERFORMANCE OF SELECTED INDIAN COMPANIES - COMPARISON DURING PRE MERGER AND POST MERGER

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Abstract

In the changing business environment every company wants to be leader in the market. The companies are forced to the external environment. After the economic reforms of liberalisation, privatisation and globalisation introduced by the government, the economic reforms through the relaxation of controls and regulations on production, trade and investment were aimed at increasing competition, improving efficiency and growth. In the present scenario most companies wants to expand their business and increase the shareholders' wealth. Hence companies are undergoing restructuring activities. M&A is one of the preferred ways to restructure and expand the business. The present study was undertaken to study the impact of merger on financial performance of different companies. A sample of 20 companies which have undergone merger between 2006 & 2009 and financial data of sample companies were used from ***2001 to 2014*** *for the study. Five year pre and five year post merger financial performance was analysed. The tool for the analysis used was ratio analysis, t-test. The result showed a mixed performance.*

Keyword: Corporate Restructuring, Merger, Ratio Analysis.

Introduction

In this competitive economy every organisation wants to explore new market in domestic country as well as in global economy and expand the business. Now all over the world the success point is the competitiveness and competitive advantage. Business environment is changing very fast in continuous basis. The companies are forced by the changes in the external environment such as stiff competition, new product, new market, costumer taste & preference, new technology, government policy, economic cycle etc. Every company wants to grow through organic route or inorganic route. The financial engineers and managers apply different theories to make use of resources. Merger and acquisition play a vital role in this aspect. Merger and acquisition transactions bring separate companies together to form bigger ones. The main objective behind any merger is to enhance the shareholders' wealth. Strong companies acquire other companies to create more competitive and cost effective company. Indian companies are now eyeing global markets instead of domestic market to move up the growth ladder. Indian companies are now aggressively looking at North American and European market to expand their business and become global players.

Merger and Acquisitions in Indian Industry

The real momentum for mergers and acquisitions in India came from the economic reforms of liberalisation, privatisation and globalisation introduced by the government. The economic reforms through the relaxation of controls and regulations on production, trade and investment were aimed at increasing competition, improving efficiency and growth. With introduction of economic reforms, the Indian companies were exposed to considerable degree of competition both domestic and international.

Figure 1: No. of Mergers & Acquisitions India

Source: https://imaa-institute.org

A study undertaken by Grant Thornton (India) in the year 2006 and reveals that mergers and acquisitions are a significant form of business strategy today among Indian companies. The objectives behind mergers and acquisitions were:

- Improving revenues and profitability
- Faster growth in scale and quicker to market
- Acquisition of new technology.

Table 1: Objectives behind M&As among Indian companies

Objectives behind M&A Transactions	**Responses (%)**
Improving revenues and profitability	33
Faster growth in scale and quicker time to market	28
Acquisition of new technology	22
To eliminate competition & increase market share	11
Tax shield & Investment savings	3
Source: *Grant Thornton(India), The M&A and Private Equity Scenario*	

Merger seems to increase revenues and profitability and as a whole increase financial performance. The present study is about to analyse the financial performance of mergers during pre & post merger in Indian companies.

Literature Review

Katsuhiko Ikeda and Noriyuki Doi (1983) studied the financial performances of 43 merging firms in Japanese manufacturing industry and found that the rate of return on equity increased in more than half the cases, but rate of return on total assets was improved in about half the cases. However, both profit rates International Research Journal of Finance and Economics - Issue 22 (2008) 195 showed improvement in more than half the cases in the five-year test, suggesting that firm performances after mergers began to be improved along with the internal adjustment of the merging firms: there was a necessary gestation period during which merging firms learnt how to manage their new organizations.

Lubatkin (1983) reviewed the findings of studies that have investigated either directly or indirectly the question, “Do mergers provide real benefits to the acquiring firm?” The review suggested that acquiring firms might benefit from merging because of technical, pecuniary and diversification synergies.

Healy, Palepu, and Ruback (1992) examined post-acquisition performance for 50 largest U.S. mergers between 1979 and 1984 by measuring cash flow performance, and concluded that operating performance of merging firms improved significantly following acquisitions, when compared to their respective industries.

Das (2000) compares the pre merge and post merger operating profit margin for a sample of 14 acquiring firms and find a decline in profitability in 8 of these companies after merger.

Ghosh (2001) examined the question of 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.

Pawaskar (2001) analysed the pre-merger and post-merger operating performance of 36 acquiring firms during 1992-95, using ratios of profitability, growth, leverage, and liquidity, and found that the acquiring firms performed better than industry average in terms of profitability. Regression Analysis however, showed that there was no increase in the post-merger profits compared to main competitors of the acquiring firms.

Surjit Kaur (2002) compared the pre and post-takeover performance for a sample of 20 acquiring companies during 1997-2000, using a set of eight financial ratios, during a 3-year period before and after merger, using t-test. The study concluded that both profitability and efficiency of targeted companies declined in post- takeover period, but the change in post-takeover performance was statistically not significant.

Kruse, Park and Suzuki (2003) examined the long-term operating performance of Japanese companies using a sample of 56 mergers of manufacturing firms in the period 1969 to 1997. By examining the cash-flow performance in the five-year period following mergers, the study found evidence of improvements in operating performance, and also that the pre and post-merger performance was highly correlated. The study concluded that control firm adjusted long-term operating performance following mergers in case of Japanese firms was positive but insignificant and there was a high correlation between pre and post-merger performance.

Beena (2004) analysed the pre and post-merger performance of a sample of 115 acquiring firms in the manufacturing sector in India, between 1995-2000, using a set of financial ratios and t-test. The study could not find any evidence of improvement in the financial ratios during the post-merger period, as compared to the pre-Merger period, for the acquiring firms.

Allred et al. (2005) found in his studies that impact of mergers and acquisitions is also due to the unequal sizes of mergers. If the companies merged or acquired are of different sizes, there would be power imbalance especially if the acquired is of a smaller size. The larger acquiring company does not bother to accommodate the issues of the acquired company, thereby not focusing on the integration areas. This could be the reason for merger failure.

Marina Martynova, Sjoerd Oosting and Luc Renneboog (2007) investigated the long-term profitability of corporate takeovers in Europe, and found that both acquiring and target companies significantly outperformed the median peers in their industry prior to the takeovers, but the profitability of the combined firm decreased significantly following the takeover. However, the decrease became insignificant after controlling for the performance of the control sample of peer companies.

Guest, Bild, and Runsten (2010) observed that both the event study methodology and the accounting returns methodology had limitations that did not determine the true fundamental valuation of an acquisition. Their approach is similar to the EVA approach. They proposed an alternative approach which they called the residual income approach, wherein they compare the fundamental value of acquirers before acquisition with the fundamental value post acquisition.

Sunje, Rahimić and Filipović (2012) focused on the importance of the compatibility in management style in acquired companies. However, along with a research done by means of a questionnaire they analyzed financial results of 43 Croatian target companies acquired in the period from 1998 to 2006. An insight into comparison of selected financial indicators (EBITDA/SALES, EBIT/SALES, ROS, ROA and ROE) in the year of a takeover with the average of their value in three years following the takeover indicated that almost 70% of analysed companies performed better after the takeover.

Vretenar (2012) explored post-M&As operating performance by measuring the change in assets, equity capital, revenues, number of employees, labour productivity and profit/losses for a sample consisting of 40 Croatian publicly listed companies taken over in the 2001-2007 period. Data was extracted for a seven years period (or shorter if there was no data available) in a way to cover for the two years before the M&A and five years following the M&A. Regarding profit, the analysis of the change in profit margin showed profitability enhancement for the majority of the firms with big losses and a profitability decrease for the entire sub-sample group of firms with the highest earnings prior to takeover. Although both previous studies deal with profitability of target companies, to the authors' knowledge only

Višić (2013) performed a research on Croatian companies the effect of takeover on company's profitability was analyzed by using several profitability measures and the research has been performed on the sample of 70 Croatian companies which were taken over in the period from year 2003 to 2008. The paper concluded that the same sample and the same reference period can lead to significantly different conclusions.

Objectives

- To identify the motives of merger in Indian context
- To analyse the financial performance of different companies during pre and post merger

Importance of the study

The 21st century has witnessed substantial global changes in the economic environment. These changes may be due to the industrial, import & export, fiscal and financial policies. Many efficient business houses collapsed, many financial engineering activities came into being for the survival of business. Merger and Acquisitions is one such area which has emerged recently. Most of the corporate houses are going for Merger and Acquisitions with an objective to create synergy and enhance the shareholder's wealth. Most of the Merger and Acquisitions deal fails to achieve success. It is important to study the financial performance of the companies, whether the merging companies are accomplishing their objectives and maximizing shareholder's wealth.

Research Methodology

Research is a process of systematic and in-depth study or search for any particular topic, subject or area of investigation, backed by collection, compilation, presentation, analysis and interpretation of relevant details or data. Methodology directs the researcher to conduct the research in a systematic manner and deals with sampling plan and various tools to carry out the analysis on the data collected.

Sources of data
The financial data required for this analysis was taken from Prowess data base of CMIE. The sample firms were taken from different Industries like Cement, Electricals, Textiles, Health care, Financial Sector, FMCG, food Processing. The final sample industry wise break up for the study is shown in Table 2 below.

Table 2: Industry wise no. of merger in the sample

Sector	No. of Merger
Cement	4
Electricals	3
Financial Sector	3
FMCG, Food Processing	3
Health care	4
Textile	3

Methodology
The pre-merger and post-merger averages for a set of financial ratios (PBT/Net Sales, PBIT/Cap Employed, PAT/Net worth, PAT/No. of Shares, Div./No of Shares & Debt equity ratio) was computed for each companies. A average pre merger and post merger financial performance ratios were compared to see if there was any statistically significant change in financial performance due to merger paired two sample t-test at confidence level of 0.05.

Time period of the Study
The data used for Analysing financial performance is from 2001-2014. The sample companies for the study were taken which have undergone mergers during the period 2006 to 2009.The analysis of all sample merged companies was conducted for five post merger years and five pre merger years to get somewhat clear picture of success or failure of mergers in terms of growth and value addition.

Data Analysis

Table 3: Pre Merger Financial Ratios

Sl No.	Name of Company	PBT/Net Sales	PBIT/Cap Empl	PAT/NW	PAT/No. of Shares	Div./No of Shares	D/E
1	**Name of Company**	0.28	0.17	0.20	6.40	**2.01**	**0.39**
2	ACC	0.14	0.12	0.22	24.22	**4.44**	3.48
3	C & S Electric Ltd.	0.03	0.29	0.17	**1.63**	0.86	**1.05**
4	Crompton Greaves	**0.08**	**0.27**	**0.22**	15.79	**4.43**	**0.65**
5	Dabur Foods Ltd.	0.14	0.09	0.12	6.25	**2.34**	**1.09**
6	Dalmia Cement	0.04	0.13	0.10	**4.26**	1.85	**1.32**
7	Edelweiss Capital	0.01	0.20	0.10	4.78	1.61	2.01
8	Fem Care Pharma Ltd.	0.05	0.32	0.13	4.73	2.45	**0.23**
9	Havells India	0.06	0.20	0.19	9.72	2.58	1.30
10	Intas Pharmaceuticals Ltd.	**0.01**	**0.13**	**0.08**	**5.72**	**2.04**	2.17
11	J B Chemicals & Pharmaceuticals Ltd.	0.10	0.23	0.17	30.72	**2.98**	**0.55,**
12	L K P Securities Ltd.	0.11	0.28	0.24	35.50	5.93	**0.88**
13	National Textile Corpn. Ltd.	0.11	0.30	0.13	**13.83**	**3.99**	**0.43**
14	Nimbus Foods Inds. Ltd.	0.08	0.54	**0.27**	9.25	1.33	0.33
15	O C L India Ltd.	0.09	0.13	0.07	3.62	1.75	**0.32**
16	Ranbaxy Laboratories	**0.09**	0.19	0.17	**0.86**	**0.24**	**0.70**
17	Ruchi Soya Industries	0.10	0.20	0.10	**6.78.**	3.33	**0.16**

18	Shree Rajasthan Syntex Ltd.	0.03	0.29	0.17	**6.29**	**2.50**	**1.72**
19	Sugal & Damani Share Brokers Ltd.	0.05	0.16	0.10	3.44	1.80	**0.31**
20	Suryavanshi Spinning Mills Ltd.	0.18	0,10	0.29	37.53	**0.25**	2.36

Table 4: Post Merger Financial Ratios

Sl No.	Name of Company	PBT/Net Sales	PBIT/Cap Empl	PAT/NW	PAT/No. of Shares	Div./No of Shares	D/E
1	ACC	0.20	0.12	0.12	5.03	**3.00**	**0.73**
2	C & S Electric Ltd.	0.11	0.14	0.11	19.61	**7.40**	0.30
3	Crompton Greaves	0.01	0.01	0.04	**2.55**	0.10	**1.85**
4	Dabur Foods Ltd.	**0.09**	**0.28**	**0.25**	14.52	**6.35**	**0.68**
5	Dalmia Cement	0.07	0.06	0.05	5.91	**2.56**	**1.32**
6	Edelweiss Capital	0.04	0.17	0.10	**5.16**	1.33	**1.62**
7	Fem Care Pharma Ltd.	0.00	0.17	-0.02	-1.14	0.59	1.51
8	Havells India	0.02	0.14	0.07	2.50	1.50	**1.57**
9	Intas Pharmaceuticals Ltd.	0.05	0.10	0.08	6.57	2.24	0.87
10	J B Chemicals & Pharmaceuticals Ltd.	**0.09**	**0.21**	**0.17**	**18.61**	**5.06**	0.61
11	L K P Securities Ltd.	0.12	0.20	0,20	20.23	**4.82**	**0.87**
12	National Textile Corpn. Ltd.	0.03	0.09	0.04	5.45	2.43	**1.61**
13	Nimbus Foods Inds. Ltd.	0.07	0.17	0.12	**21.89**	**4.83**	**1.36**
14	O C L India Ltd.	-0.09	-0.19	**1.29**	-17.57	0.69	-0.74
15	Ranbaxy Laboratories	-0.03	0.06	-0.11	-4.96	0.67	**1.46**
16	Ruchi Soya Industries	**0.19**	0.06	0.01	**2.18**	**0.43**	**1.68**
17	Shree Rajasthan Syntex Ltd.	0.05	0.10	0.05	**8.16**	3.33	**1.00**
18	Sugal & Damani Share Brokers Ltd.	0.02	0.19	0.10	**27.16**	**15.67**	**2.26**
19	Suryavanshi Spinning Mills Ltd.	-0.18	-0.04	-0.79	-11.10	0.36	**2.44**
20	Zuari Cement Ltd.	0.10	0.06	0.12	30.91	**8.44**	1.09

The result of comparision of financial ratios of sample companies during pre merger and post merger have been presented in Table 3 & Table 4 respectively. It can be revealed that Dabur foods ltd, JB Chemicals & Pharmaceuticals ltd and Ruchi Soya Industries have improved their profitability in post merger period. ACC, C&S Electric Ltd, Dalmia Cement, have increase dividend despite fall in profitability in post merger period. some companies like Crompton Graves, Edelweiss capital, Nimbus Foods Inds. ltd, Shree Rajastan Syntex Ltd have increased EPS despite decline in profitabilityin post merger period. All companies except Zuari Cement Ltd., OCL India ltd, Intas Pharmaceuticals, Fem Care Pharma Ltd, C&S electric ltd improved D/E ratio in post merger period.

Table 5: Average Pre & Post Merger Ratios

Ratios	Pre Merger	Post Merger	t(0.5 significance)
PBT/Net Sales	0.089	0.048	0.812
PBIT/Cap Empl	0.212	0.105	1.637
PAT/NW	0.162	0.090	2.772
PAT/No. of Shares	11.227	6.726	3.793
Div./No of Shares	2.316	3.590	5.827
D/E	1.045	1.205	-1.086

The average of pre merger and post merger performance ratios were calculated in above Table 5. Average pre merger and post merger financial performance ratios were compared. The result of pre merger and post merger showed a decline in the mean profit before tax to net sales 0.089 to 0.048, but the decline was not statistically significant as t-static value of 0.812. However Profit before interest &tax to capital employed (0.212 to 0.105), Profit after tax to net worth (0.162 to 0.090), EPS

(11.227 to 6.72.6) showed statistically significant decline in post merger period as t-static value is 1.637, 2.772, 3.793 respectively.

Average of dividend per share (2.316 to 3.590) showed statistically significant increase in post merger period. There was a increase in D/E (1.045 to 1.205) increase but statistically not significant.

Conclusion

The present study carried out in computation of six financial ratios for twenty companies for both pre and post merger. The study was done to know the impact of merger on financial performance. A set of financial ratios like PBT/Net Sales, PBIT/Cap Employed, PAT/Net worth, PAT/No. of Shares, Div./No of Shares & Debt equity ratio was computed for each companies and average pre merger and post merger financial performance ratios were compared to see if there was any statistically significant change in financial performance due to merger using paired two sample t-test at confidence level of 0.05. The analysis reveals mixed outcome in different companies. Most companies increased EPS and D/E despite decline in profitability and Dabur foods ltd, JB Chemicals & Pharmaceuticals ltd and Ruchi Soya Industries have improved their profitability in post merger period. Average pre merger and post merger financial performance ratios were compared. The result of pre merger and post merger showed a decline in the mean profit before tax to net, but the decline was not statistically significant. However Profit before interest & tax to capital employed, profit after tax to net worth and EPS showed statistically significant decline in post merger period. Average of dividend per share showed statistically significant increase in post merger period. There was a increase in D/E ratio but statistically not significant.

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