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FINDINGS
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ANALYZING THE SHORT RUN OPERATING PERFORMANCE OF ACQUISITIONS: INDIAN PERSPECTIVE

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ABSTRACT

In today's global economy, Mergers and Acquisitions (M&A) are being increasingly used world over as a strategy for achieving larger size and faster growth in market share and reach, and to become more competitive through economies of scale. This research study aims to study the impact of mergers in the short run on the operating performance of acquiring corporate in different periods in India, by examining some pre- and post-merger financial ratios, with chosen sample firms, and all mergers involving public limited and traded companies of the nation between 2009 and 2013. The result shows that for a short run operating performance, the impact is not high on the performance of the acquiring companies. An analysis of pre- and post-merger operating performance ratios for the entire sample set of mergers shows that while there was no change in the mean operating profit margin and gross profit margin ratios, there was significant decline in the net profit margin. A small increase in ROCE and debt equity ratio is observed.

KEYWORDS
Acquisition, merger, market share.

1. INTRODUCTION

In today's globalized economy, competitiveness and competitive advantage have become the buzzword for corporate around the world. Companies are increasingly using Mergers and Acquisitions as a way for entering new markets, asset growth, garnering greater market share/additional manufacturing capacities, and gaining complementary strengths and competencies, and to become more competitive in the market place.

The Indian economy has undergone a major transformation and structural change following the economic reforms introduced by the Government of India in 1991. Since then, the M&A movement in India have gained momentum. In the liberalized economic and business environment, 'magnitude and competence' has become the main focus of every business enterprise in India, as companies have realized the need to grow and expand in businesses that they understand well in order to face the growing competition. Indian corporate has undertaken restructuring exercises to sell off non-core businesses and to create stronger presence in their core areas of business interest. M&A emerged as one of the most effective methods of such corporate restructuring and have, therefore, become an integral part of the long-term business strategy of corporate in India.

The volume of M&A transactions in India has apparently increased to about 67.2 billion USD in 2010 from 21.3 billion USD in 2009. The year 2010 saw a major shift in the corporate behaviour towars M&A transctions. This research study aims to study the impact of mergers on the operating performance of acquiring corporate in different periods in India by examining some pre- and post-merger financial ratios, with chosen sample firms, and all mergers involving public limited and traded companies of the nation between 2009 and 2013.

1.1 RESEARCH MOTIVATION

From the previous researches and studies of the impact on operating performances on the acquiring firm due to mergers it has been understood the M&A transactions may lead to improvement or no improvement at all. Though the performance of the company for the current year immediately after merger may improve, but it doesnt improve the performances in the long run. This research mainly focusses on the M&A transactions that has been carried out in the year 2009 to 2013 and to determine if the operating performance has increased/decreased for the selected companies pre and post merger.

1.2 OBJECTIVES

- To obtain relevant sample size from the domestic deals during the year 2009-2013
- To analyze the post- merger operating performances for acquiring firm in Indian industry considering only domestic deals that occurred during the year 2009-2013.
- To analyze the impact of pre and post- merger with the help of paired t-test.
- To observe the performances before and after merger of the acquiring company.

1.3 NEED AND SCOPE OF THE STUDY

Since the previous studies have compared the pre & post merger that has taken place in india, this study attempts to study the recent scenario of the performances of companies after merger. This study will focus mainly on the operating profit margin, gross profit margin, net profit margin, return on networth, return on capital employed and debt equity ratio of the acquiring firms. Only the domestic deals and firm specific acquisitions have been considered for this study. This study can be further used for the analysis between different sectors as well.

1.4 LIMITATIONS OF THE STUDY

The study has ignored the impact of possible differences in the accounting methods adopted by different companies in the sample, as the sample includes only stock-for-stock mergers. It does not include buy back of shares, or acquisition of control like management buyouts and acquiring controlling stake. Likewise, the cost of acquisition for mergers have not been considered in the study as the methodology chosen did not permit specific cases to be examined on such basis. The present study also did not use any control groups (industry average or firms with similar characteristics, as was done in some studies). The study is for the period 2009 to 2013 and only 2 years before and after merger has been analyzed which may not give accurate result as exogenous variables like changes in government policies and changing governments could have led to varying result. Those companies which have relevant information only have been considered. There are few companies which have gone for M&A transactions for consecutive year that has been neglected.

2. LITERATURE REVIEW

Flynn I Simone (2014) explains that Mergers and acquisitions are, for some countries, one of the most effective corporate development tools or tactics. Mergers and acquisitions are a key means of fast growth, increased market share, entry into new markets, expanded product offerings, strengthened supply chain, and optimized cost efficiencies (Walker, 2000).

B Lev and G Mandelker (1970) examined the profitability of mergers along such aspects as risk, growth, capital structure, income tax savings, earnings per share etc. The conclusion drawn is that the long run profitability of acquiring firms is probably somewhat higher than that of comparable non-merging firms.
Krishnakumar D and Sethi M (2012) found that most researchers have adopted either the event study methodology or accounting based measures to evaluate acquisition performance. Other methods used include economic value added, residual income approach, innovative performance, questionnaire methods. Recent studies have included newer approaches such as the data envelopment analysis and balance score card approach. The selection of the method of measurement is crucial to the results drawn, hence should be selected with great care. It is recommend that the method of evaluation should be based on the country of study, and more significantly the aspect under examination i.e. profitability, stock market perception or efficiency. Their contribution to the present body of knowledge is to suggest that methods of evaluation used in developed markets may not work in emerging markets and that method selection can influence research conclusions.
Rajesh kumar B and Rajib P (2007) determined that Merging firms are matched on the basis of pre-acquisition performance and size. Three alternate methodologies were utilized for the study in which cash flow was deflated by market value of assets, book value of assets and the sales value. The results based on book value of assets and sales model provide some evidence to suggest that corporate performance improves after mergers. The model based on market value of assets doesn't support the hypothesis that operating performance improves after mergers. The use of different deflators - accounting measures versus market measures which were sensitive to market revaluations have contributed to different results.
Bouwman H.S.C , Fuller K and Nain S A (2009) showed that significantly more acquisitions occur when stock markets are booming than when markets are depressed. Rhodes-Kropf and Viswanathan (2004) hypothesize that firm-specific and market-wide (mis-)valuations lead to an excess of mergers, and these will be value destroying. Our overall conclusion that acquirer performance is correlated with the state of the market is consistent with recent evidence that stock prices affect corporate decisions. Their results strongly suggest that, viewed through an ex post performance lens, acquisitions undertaken during periods of high-market valuations are of lower quality than those undertaken during periods of low-market valuations.
Kunal Soni B (2014) performed a study on the pre merger and post merger / acquisition on selected financial parameters for cement companies in India which concluded that acquiring companies could have achieved the objective of capacity addition and growth with the M & A, but not have been successful in improving the profitability yet. These deals would have helped the companies in brining economies of scale and price-stabilization.
Bhalla P (2014) explored the importance of India in global patterns of *M&A* in which deregulation, technology and globalization are determining factors. It was observed that India has been lagging behind other advanced and emerging economies in terms of both number as well as value of *M&A*. It has also been seen that there has been notable acceleration in *M&A* in the post 2000 period, particularly in the financial sector of India. A careful analysis reveals an interesting pattern in the *M&A* activity. The sectors such as paper products, printing, publishing, media & entertainment, food products, textiles and non-metallic mineral products, metals, machinery, automobiles and miscellaneous manufacturing have shown relatively little involvement in *M&A* activity.
Kalra R (2013) concluded that the M&As in the Indian corporate firms over a period of April 2008-March 2009 have a significant impact on the liquidity, profitability, operating performance and financial risk position of acquirer firms in India. The type of industry does seem to make a difference in the post-merger performances of the acquiring firms. The results of this study show that a management cannot take it for granted that synergy will be generated and profits will increase simply by going for mergers and acquisitions. However, it should be tested with a bigger sample size before coming to a final conclusion.
Mantravadi P and Reddy V (2007) performed analysis for different periods which showed that for merging firms during the period 1991-95, returns on net worth and capital employed have significantly declined post-merger, while profit margins were maintained at pre-merger levels. This seems to indicate a consolidation strategy adopted by merging firms, to strengthen their balance sheets during this period. For mergers during 1996-99, operating performance of acquiring firms, in terms of both profitability and returns on capital/assets, had declined following the mergers. The increase in the leverage of acquiring firms suggests that acquiring firms have raised more debt to restructure operations following the merger, thus increasing interest costs, reflected in decline of net profit margin. For mergers during 2000-03, both profitability ratios and returns ratios were unchanged, in the post-merger period.

3. RESEARCH METHODOLOGY

3.1 RESEARCH DESIGN

For this study exploratory research design has been adopted. The basic objective of the study is to explore and obtain clarity about the pre and post-merger transactions during 2009 to 2013. It is both a qualitative and quantitative analysis.

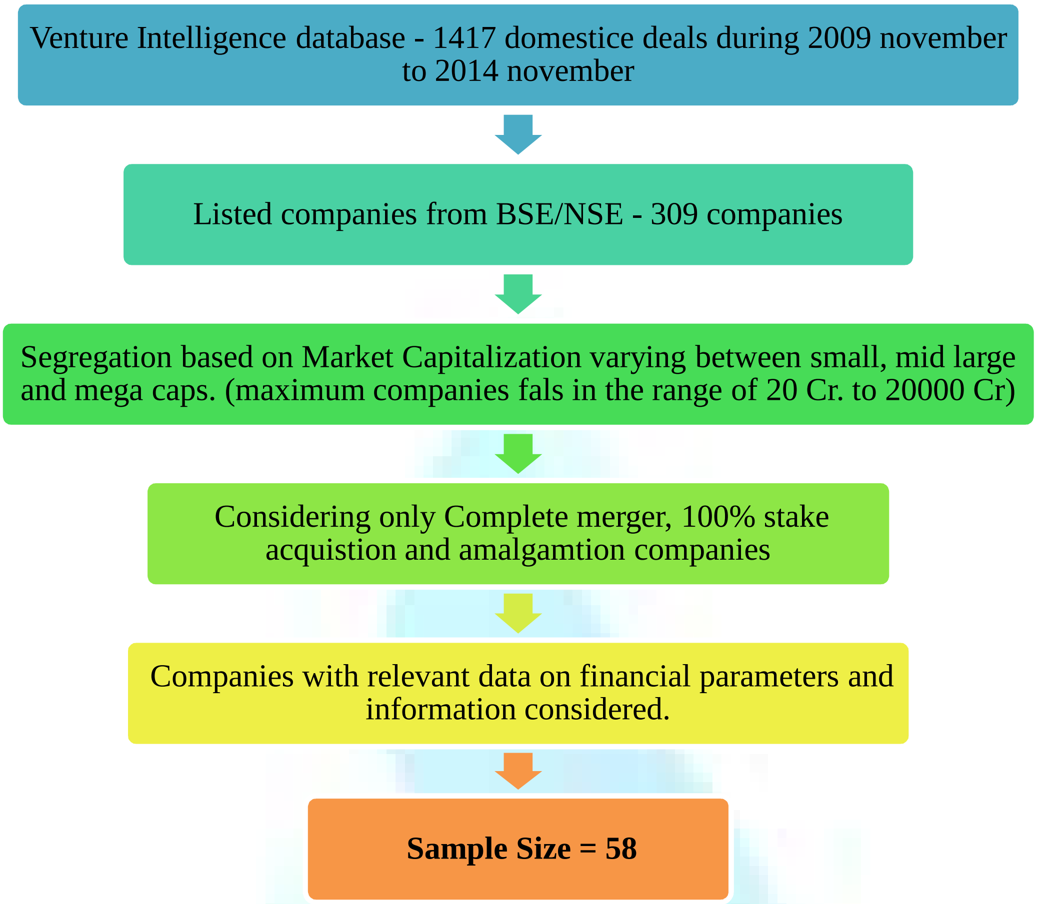
3.2 DATA COLLECTION METHODS & SOURCES

Both primary and secondary data has been collected in order to proceed with the research. Primary data involves collection of the list of current domestic deals of Mergers & Acquisitions that occurred during the year 2009 November to 2013 November. This data was collected from the venture intelligence database which provides a list of deals including mergers, acquisitions, stake acquisitions, amalgamation or wholly owned subsidiary (due to buying of remaining stake in a company) of listed and non-listed companies. The secondary source of data is collected from scholarly journals and articles related to the impact on the operating performances of the acquiring company.

3.3 SAMPLING TECHNIQUES

The sample for the study primarily included mergers by public limited companies listed on Bombay Stock Exchange (BSE)/National Stock Exchange (NSE), during the period of study. Cross-border mergers have been excluded from the sample as the research is about Indian perspective. Only stock-for-stock Mergers/Acquisitions are included in the sample. Only mergers where equity stock of acquiring firm has been issued to the acquired firm (target) shareholders, as consideration for the acquisition/merger have been considered. Merger cases where less than 10% of merging firm's equity (by value) was issued to target firm shareholders, have been removed from the sample (to eliminate cases where the merging firm was too big compared to the target firm in market value, thereby the effect of merger could be considered negligible). The process of selecting sample is as shown below:

FIG. 1



From the venture intelligence data base 1417 deals were taken into consideration for 5 year duration. From those companies only listed stock were taken which were segregated according to their market capitalization.

TABLE 1

YEAR	NO. OF COMPANIES	COMPANIES BETWEEN		
		0-200Cr	200-2000Cr	20000>
2009	14	21%	**43%**	36%
2010	102	39%	**42%**	18%
2011	82	32%	**55%**	13%
2012	71	28%	**54%**	15%
2013	40	18%	**50%**	32%

From the above table we can see that large number of companies lie in the range of 200 to 20000 Cr. Therefore only these companies were considered for sample selection. From these companies the type of M&A transaction was classified and only those companies that underwent a complete merger or 100% stake acquisition of the Target Company or amalgamation only were taken. This resulted in a sample size of 65. But since pre and post merger requires comparison of at least 2 years before and after merger, the year 2014 November was eliminated and only the companies with relevant financial parameters were taken into consideration to arrive at the sample size of 58 companies.

TABLE 2

YEAR	NUMBER OF COMPANIES FOR M&A
2009	6
2010	17
2011	14
2012	12
2013	9
Total	**58**

3.4 TOOLS OF ANALYSIS

The main tools used for analysis is Microsoft Excel and IBM SPSS. With the help of SPSS analytical tool, a paired sample t test was performed to prove statistically if the mergers and acquisitions do have an impact on the operating performances of the acquiring company. The hypothesis is as given below for the study:

Ho: Mergers & Acquisitions have not improved the operating performance of the acquiring firm

H1: Mergers & Acquisitions have improved the operating performance of the acquiring firm.

The study has adopted the methodology of comparing pre- and post-merger performances of acquiring companies, using the following financial ratios:

- Operating Profit Margin (Profit before Depreciation, Interest and Tax/Net Sales)
- Gross Profit Margin (Profit before Interest and Tax/Net Sales)
- Net Profit Margin (Profit after Tax/Net Sales)
- Return on Net-worth (Profit after Tax/Net-worth)
- Return on Capital Employed (Profit before Interest and Tax (PBIT)/Capital Employed)
- Debt-equity Ratio (Book value of Debt/Book value of Equity)

4. DATA ANALYSIS

From the data collected for 58 companies, each company was analysed based on the operating profit, net profit margin, gross profit margin, Return on net worth, Return on capital employed and debt equity ratio for the year 2009 to 2014. For those deals that occurred in each year, 2 years pre and post merger data were analysed. The detailed analysis is presented in the annexure. From the data the mean of pre and post performance is compared as shown below:

TABLE 3

YEAR 2009	PRE-MERGER	POST-MERGER	T-STATISTICS
	(2 years avg.) %	(2 years avg.)%	(0.05 significance)
Operating margin	53.54	40.71	0.1865
Gross profit margin	12.20	37.37	0.149
Net profit margin	-8.66	16.71	0.176
Return on Net worth	14.21	15.79	0.413
Return on capital employed	12.46	15.87	0.265
Debt equity ratio	2.01	1.27	0.011

The comparison of the pre- and post-merger operating performance ratios shows that there is a decrease in the mean operating profit margin (53.54% vs. 40.71%) whereas gross profit margin has increased (12.20% vs. 37.37%), during the pre- and post-merger phases. Net profit has increased drastically (-8.66% vs. 16.71%) and no significant improvement is seen in return on Net worth (14.21% vs. 15.79%) and ROCE (12.46% vs. 15.87%). Debt equity ratio has decreased (2.01% vs. 1.27%). These are validated by the low t-value which is higher than the significance level. There is enough evidence to accept the null hypothesis which states that there has been no improvement in the operating performance for the year 2009.

The financial year 2010 saw a huge increase in the Mergers & Acquisition transactions. The comparison for the year 2010 is as below:

TABLE 4

YEAR 2010	PRE-MERGER	POST-MERGER	T-STATISTICS
	(2 years avg.) %	(2 years avg.)%	(0.05 significance)
Operating margin	21.15	17.48	0.014
Gross profit margin	16.78	13.05	0.007
Net profit margin	12.45	10.09	0.0715
Return on Net worth	17.28	11.44	0.002
Return on capital employed	18.19	13.42	0.0215
Debt equity ratio	0.75	0.67	0.05

In 2010 Operating margin (21.15 vs. 17.48), Gross profit margin (16.78 vs. 13.05), Net profit margin (12.45 vs. 10.09), Return on Net worth (17.28 vs. 11.44), ROCE (18.19 vs. 13.42) and debt equity ratio (0.75 vs. 0.67) have declined considerably which is proven by the high value of t-statistics which is lesser than the significance level. This shows that there is enough evidence to reject the null hypothesis. This year shows that though there was an increase in the amount of mergers and acquisitions and there was an impact on the operating performances. The differences in the t-statistics test and the mean difference is due to the difference in the type of the companies chosen in the sample. Few companies have seen a drastic change whereas few have not. The annexure shows the different companies in the sample and their operating performances.

TABLE 5

YEAR 2011	PRE-MERGER	POST-MERGER	T-STATISTICS
	(2 years avg.) %	(2 years avg.)%	(0.05 significance)
Operating margin	19.98	-12.14	0.1805
Gross profit margin	16.24	-16.51	0.1825
Net profit margin	8.93	8.43	0.421
Return on net worth	11.39	9.12	0.1425
Return on capital employed	12.43	11.56	0.3665
Debt equity ratio	0.74	0.65	0.031

The operating margin and gross profit margin have declined drastically which is validated by high significance value. There is enough evidence to accept the null hypothesis which concludes that the mergers and acquisition activity has not improved the operating performance.

TABLE 6

YEAR 2012	PRE-MERGER	POST-MERGER	T-STATISTICS
	(2 years avg.) %	(2 years avg.)%	(0.05 significance)
Operating margin	23.37	26.04	0.2645
Gross profit margin	21.03	24.04	0.2455
Net profit margin	10.02	20.53	0.105
Return on net worth	12.87	14.30	0.319
Return on capital employed	17.74	15.64	0.243
Debt equity ratio	1.08	0.92	0.329

In the year 2012 there is no significant improvement in all the operating performances of the acquiring firms which is validated by t-statistics which is higher than the significance value which leads to the acceptance of null hypothesis. This implies that the M&A activity have not increased the operating performance.

TABLE 7

YEAR 2013	PRE-MERGER	POST-MERGER	T-STATISTICS
	(2 years avg.) %	(2 years avg.)%	(0.05 significance)
Operating margin	14.84	16.33	0.1695
Gross profit margin	11.62	12.33	0.337
Net profit margin	7.31	7.10	0.445
Return on net worth	6.23	85.74	0.189
Return on capital employed	16.13	15.84	0.4675
Debt equity ratio	2.50	7.55	0.1675

Since there is no significant improvement in the financial parameters pre and post mergers it leads to conclude that there the null hypothesis is accepted.

In order to conclude the analysis, the average is taken for each parameter, i.e. operating margin, gross profit margin, net profit margin, return on net worth, return on capital employed and debt equity ratio and compared between pre merger and post merger.

TABLE 8

	Pre-merger	Post-merger
Operating margin	26.58	17.69
Gross profit margin	15.58	14.06
Net profit margin	6.01	12.57
Return on net worth	12.39	27.28
Return on capital employed	15.39	14.47
Debt equity ratio	1.41	2.21

From the result we can see that the operating margin has declined from 26.58% to 17.69%, Gross profit margin has decreased by 1.52% which is not a significant improvement due to a merger. It is observed that the net profit margin has increased by 6% along with an increase in the return on net worth by 14.8%. Therefore from the comparison we can see that the overall operating performance of the acquiring companies have not shown a significant improvement in the short run after merger.

5. FINDINGS

From the analysis it shows that Mergers and Acquistion activities have not improved the operating performance of the acquiring companies. The sample size has a variety of companies which belong to different sectors like electric equipment, finance-investment, breweries & distilleries, cement, real estate, sugar, auto ancillaries, computer-software & hardware, packaging, paper, media & entertainment, fertilisers, textiles, telecommunication, pharamceuticals etc. Due to the varied sectors, the impact on the operating performances varies too. The sample size considers all the companies in the range of 200 Cr to 20000 Cr market capitalization. Only in the year 2010, according to t-test, the M&A has had an impact on the operating performances of the acquiring company. Though the mean average shows a varying result. This is due to the fact that the sample size consists of 17 companies from different sectors. The post merger values are declining due to drastic changes in the individual companies which has resulted in a difference in the mean average and t-statistics.

From the analysis we can see that the mergers and acquistion does nit have an significant impact on the operating performance of the company. If the analysis was carried out for a longer duration pst merger the actual scenario could have been analysed.

6. RECOMMENDATION

It is recommended that the Post merger operating performance should be studied for a longer duration at least for 5 years as this research is limited to study the impact on the operating performances post merger is only 2 years. The study can also involve the companies with different market capitalization and a comparative study can be performed to check the impact on operating performances in micro cap, small cap, mid cap, large cap and mega cap sectors and to check which sectors have a better performance.

This study is has taken 6 parameters for studying the operating performance, it can be further studied using PBDIT, PBT, PAT, PBDIT/total income, PBT/total income, PAT/total income comparison.

7. CONCLUSION

An analysis of pre- and post-merger operating performance ratios for the entire sample set of mergers shows that while there was no change in the mean operating profit margin and gross profit margin ratios, there was significant increase in the net profit margin. A small increase in ROCE and debt equity ratio is observed.

These results corroborate the general research results on post merger operating performance in other countries, which suggested that the operating performance either stagnates or declines after mergers, for acquiring firms.

8. SCOPE FOR FURTHER STUDY

Future research in this area could be an extension of the present study by estimating and comparing with industry/sector averages, and the differences, if any could be probed further to derive further insights. Researchers could also analyze the returns to shareholders of acquiring firms involved in mergers in India to correlate with findings of studies indicating poor post-merger performance.

The impact on the cash flows of the acquiring firms can be studied. Cross border mergers and acquisition activities can be analyzed for different periods. This can also lead to carrying out the performance measures of different sectors both domestically and cross border transactions.

Further cross border acquisitions can be classified according to cash financed acquisition, stock financed, acquisitions with competitive bidders, acquisition with single bidder, hostile acquisition, friendly acquisition, related acquisition etc.

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