



INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE, ECONOMICS AND MANAGEMENT

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MERGER AND ACQUISITION ACTIVITY IN THE INDIAN MANUFACTURING SECTOR AND SHAREHOLDER VALUE ADDITION IN THE MERGED ENTITIES

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ABSTRACT

The forces of liberalization, privatization and globalization that swept the Indian economy in the post-reforms era, compelled the corporate to restructure their businesses by adopting various strategies like mergers, amalgamations and takeovers. The present study makes a probe into the shareholder value addition of the 46 select merged entities in the manufacturing sector during the five post merger periods. The intra-firm analysis with EVA and MVA carried out in the study revealed that majority (80%) of the merged companies had no definite trend in value addition during the post merger periods.

KEYWORDS

Economic Value Added (EVA), Market Value Added (MVA).

INTRODUCTION

Corporate restructuring has gained considerable importance all over the world because of intense competition, globalization and technological changes. The process got accelerated with the opening of the economy to attract foreign investment. The forces of liberalization, privatization and globalization (LPG) that swept the Indian economy in the post-reforms era compelled the corporates to restructure their businesses by adopting various strategies like mergers, amalgamations and takeovers.

In corporate literature, the motives for mergers are manifold in the light of the fact that different acquiring firms may have different motives. The different schools of thought on merger theories can be broadly classified as those based on capital market valuation of firms and actions of managers primarily based on the empire building motives of corporate managers. Some merger theories incorporate a blend of managerial and capital market elements which state that in a scenario where the managers deviate from the shareholders best interests, firms that behave inefficiently are likely target for takeover because of capital gains that could be realized by a successful raider.

THE NEED AND OBJECTIVES OF THE STUDY

The operating and financial economies of scale and scope are certainly the major determinants of merger activity. The literature discussing the motivation for mergers may be broadly classified into the neoclassical shareholder wealth maximizing approach and new managerial theories. The former theory hypothesizes that managers will pursue M & As when such investments appear to offer a positive net present value based upon the discounted value of their estimated cash flows. The new managerial theories argue that with evidencing share ownership and consequential divorce between ownership and control, managers may seek to maximize their own self-interest. Shareholder value addition and survival of the fittest have become the buzz words with the transition of Indian economy to a market driven environment.

This paper focuses on evaluating the post-merger performance of the merged companies by way of intra-firm comparisons using Value Added metrics of corporate performance such as Economic Value Added and Market Value Added and to identify the specific gainers or losers after merger.

METHODOLOGY

PERIOD OF THE STUDY

The empirical study of all sample merged companies has been conducted for five post-merger years. The year of merger has been excluded from the analysis, to have consistency in evaluating post-merger performance of these companies.

SELECTION OF SAMPLE

The sample of the study is selected from the universe of M & As in the manufacturing sector in India. Then, by scrutinizing the Bombay stock Exchange official Directory, all companies which had merged before 1st April 2000 has been eliminated so as to have a sample consisting of companies which have undergone mergers in the second decade of economic reforms i.e. from the period 1st April 2000 to April 2004.

Further, those companies which had undergone series of mergers during the period have also been excluded because post-merger performance in such cases could not be related to single merger event.

Finally, those companies whose financial data were not available for the time period chosen for the study viz. five years before and after merger were excluded from the sample.

Accordingly in all, 46 merged companies in the manufacturing sector comprising of different industries have been included in the sample.

The list of the sampled companies is given in Table 1

TABLE 1: LIST OF SELECTED MERGED COMPANIES

S. No.	Acquirer Company	S. No.	Acquirer Company
1	Aarti Industries Ltd	24	Lloyds Steel Industry. Ltd
2	Abhishek Industries Ltd	25	Lloyds Metals and Engineers Ltd
3	ACC Ltd	26	Matrix Laboratories Ltd
4	Andhra Pradesh Paper Mills Ltd	27	Nagarjuna Fertilizer & Chem. Ltd
5	Aurobindo Pharam Ltd	28	North Tukvar Tea Co Ltd
6	Aventis Pharma Ltd	29	Novartis India Ltd
7	Basf India Ltd	30	Organan (India) Ltd
8	Cadila Healthcare Ltd	31	Pfizer Ltd
9	Choksi Imaging Ltd	32	Philips Electronics Ltd
10	Deepak Nitrite Ltd	33	Piramal Healthcare Ltd
11	ECO Auto Components Ltd	34	Polar Industries Ltd
12	Eveready Industries India Ltd	35	Sagar Cements Ltd
13	Federal-Mogul Goetz (India) Ltd	36	Sandvik Asia Ltd
14	Gabriel India Ltd	37	Siemens Ltd
15	Gillanders Arbuthnot & Co Ltd	38	Sun Pharma Inds.Ltd
16	Glaxo Smithline Pharmaceuticals	39	Sundram Fastners
17	Granules India Ltd	40	Tata Steel Limited
18	Grasim Industries	41	Tube Investment Of India Ltd
19	Indian Aluminium Company	42	TVS Electronic Ltd
20	Interfit India	43	TVS Motor Co Ltd
21	Joonktollee & Inds. Ltd	44	Usha International Ltd
22	KSB Pumps Ltd	45	Wanbury Ltd
23	Lakshmi Machine Works Ltd	46	Wyeth Ltd

DATA SOURCE AND TOOLS OF ANALYSIS

The present study is based on secondary data. The secondary data were collected for five years after merger. The required data for the study were obtained from the Prowess, the corporate database software of CMIE and CAPITALINE, the data base software developed by Capital Market Publishers Private India Limited. The various websites have also been the sources of the required data.

Cluster analysis has been employed to classify the firms into groups so that items within the groups are fairly and sufficiently more homogenous than across different groups.

RESULTS AND DISCUSSION

The post merger performance of the sample merged companies has been carried out using value added metrics namely:

- Economic Value Added (EVA) and
- Market Value Added (MVA)

ECONOMIC VALUE ADDED (EVA)

EVA is the difference between Net Operating Profit after Tax (NOPAT) and the capital charge for both the debt and equity (overall cost of capital). If NOPAT exceeds the capital charge EVA is positive and if reverse is the case it is negative. It shows whether a company is creating real value for its share holders in terms of its economic performance.

MARKET VALUE ADDED (MVA)

MVA measures market's assessment of firm's value, which is the value, added by the management over and above the capital invested in the company by investors.

$$\text{MVA} = \text{Market Value of the firm} - \text{Book Value of the firm}$$

$$\text{Market Value of the firm} = \frac{\text{Profit before interest and taxes}}{\text{Weighted average cost of capital}}$$

$$\text{Book Value of the firm} = (\text{Equity Capital} + \text{Reserves and surplus}) - (\text{Revaluation Reserve} + \text{Miscellaneous Expenses})$$

In order to find out whether share holder value has improved over five post merger years, absolute EVA and MVA figures have been converted into relative figures by applying the following formula.

Economic Value Added as a percentage of Capital Employed (EVACE)

$$= \frac{\text{Economic Value Added}}{\text{Capital Employed}} \times 100$$

Market Value Added as a percentage of Capital Employed (MVACE)

$$= \frac{\text{Market Value Added}}{\text{Capital Employed}} \times 100$$

INTRA – FIRM COMPARISON WITH EVA AND MVA

The performance of the forty six select merged firms in terms of EVA and MVA are exhibited in Tables 2 and 3. Cluster analysis has been made to understand the variations across five post – merger years in terms of EVA and MVA. Accordingly, the firms which presented the trend of increasing value addition across post merger years have been brought under Group I and those with decreasing trend were brought under Group II and those which showed fluctuating trend were brought under Group III.

EVA AND INTRA FIRM COMPARISON

EVA has been calculated for all the sample 46 companies for the five post – merger years to ascertain whether shareholder value has improved in post- merger period. The results of the analysis are presented in Table 2.

TABLE 2: INTRA-FIRM ANALYSIS WITH EVA

S. No	Name of Merged Companies	EVACE (in %) - Post Merger Years					Group
		Year 1	Year 2	Year 3	Year 4	Year 5	
1	Aarti Industries Ltd	5.74	5.42	6.87	8.20	6.46	III
2	Abhishek Industries Ltd	-4.50	-2.06	4.29	3.42	4.01	III
3	ACC Ltd	9.15	11.79	22.40	9.73	7.89	III
4	Andhra Pradesh Paper Mills Ltd	-1.98	-0.39	1.48	2.32	1.79	III
5	Aurobindo Pharma Ltd	6.20	3.97	4.96	4.92	-0.51	III
6	Aventis Pharma Ltd	29.52	21.60	20.52	12.57	11.97	II
7	BASF India Ltd	-0.27	2.26	1.17	-19.73	-81.07	III
8	Cadila Healthcare Ltd	10.50	9.13	9.71	9.57	8.07	III
9	Choksi Imaging Ltd	-4.97	2.60	8.06	6.64	7.22	III
10	Deepak Nitrite Ltd	2.40	3.50	4.64	7.08	-2.66	III
11	ECO Auto Components Ltd	-7.18	-1.56	-43.68	30.10	4.64	III
12	Eveready Industries India Ltd	-0.76	-11.18	-2.66	-3.53	2.46	III
13	Federal-Mogul Goetz (India) Ltd	0.05	0.06	-0.09	-0.01	-0.02	III
14	Gabriel India Ltd	3.92	6.06	6.47	1.48	29.83	III
15	Gillanders Arbuthnot & Co Ltd	-2.32	-3.03	-2.19	1.47	2.00	I
16	Glaxo Smithline Pharmaceuticals	5.93	29.54	32.42	26.07	24.53	III
17	Granules India Ltd	-2.10	1.61	2.29	5.47	1.88	III
18	Grasim Industries	-1.22	-0.51	0.99	8.05	8.81	I
19	Indian Aluminium Company	1.61	3.01	-14.00	-15.23	-20.02	III
20	Interfit India	-19.56	-6.46	-4.50	-9.11	-7.04	III
21	Joonktolle & Inds. Ltd	-12.70	-10.03	-8.26	0.81	-1.94	III
22	KSB Pumps Ltd	-3.86	0.50	3.51	11.93	13.94	I
23	Lakshmi Machine Works Ltd	3.19	-0.51	26.90	28.19	24.10	III
24	Lloyds steel inds. Ltd	-15.78	-10.29	-7.98	4.73	13.89	III
25	Lloyds Metals and Engineers Ltd	-14.28	-13.45	-3.29	4.24	19.82	III
26	Matrix Laboratories Ltd	8.24	10.79	0.19	-31.86	7.05	III
27	Nagarjuna Fertilizer & Chem. Ltd	-0.60	-5.09	0.64	-2.83	-1.95	III
28	North Tukvar Tea Co Ltd	-12.88	-5.90	6.69	3.86	-1.07	III
29	Novartis India Ltd	5.62	10.66	29.04	4.84	5.15	III
30	Organan (India) Ltd	-9.26	3.14	5.94	-5.64	-4.32	III
31	Pfizer Ltd	0.81	4.17	11.95	18.74	44.36	I
32	Philips Electronics Ltd	12.15	-6.46	-5.64	-3.83	-3.71	III
33	Piramal Healthcare Ltd	11.41	19.11	14.62	5.03	5.32	III
34	Polar Industries Ltd	-19.14	2.07	-0.84	-10.15	-331.89	III
35	Sagar Cements Ltd	1.83	2.47	21.61	7.53	0.53	III
36	Sandvik Asia Ltd	-3.99	2.32	2.92	-93.63	-36.50	III
37	Siemens Ltd	16.52	26.25	25.22	23.28	-170.07	III
38	Sun Pharma Inds.Ltd	5.98	18.53	14.88	8.41	11.61	III
39	Sundram Fastners	9.02	8.93	5.87	5.68	4.07	II
40	Tata Steel Limited	10.19	17.39	29.73	21.63	13.25	III
41	Tube Investment Of India Ltd	9.75	18.40	10.95	-1.25	-0.02	III
42	TVS Electronic Ltd	12.13	-2.26	2.59	3.28	1.99	III
43	TVS Motor Co Ltd	10.93	10.31	5.67	0.09	-2.36	II
44	Usha International Ltd	-2.89	-0.78	1.77	3.12	6.21	I
45	Wanbury Ltd	-2.96	3.26	2.13	4.36	-8.98	III
46	Wyeth Ltd	-2.99	10.29	2.60	15.78	21.50	I

Source: Results computed

It is observed from Table 2 that ,out of the 46 companies , 6 companies (13%) showed an increasing trend of share holder value addition (group I) in the post-merger years i.e., the performance of such companies indicate improvement from the first post-merger year to the fifth post-merger year. These companies include Grasim Industries, Gillanders Arbuthnot & Co Ltd, KSB Pumps Ltd, Pfizer Ltd, Usha International Ltd and Wyeth Ltd. However only one company, i.e, Pfizer Ltd., could record positive upward value addition to the shareholders in all the post-merger years. A marked increase in share holder value addition was revealed by KSB Pumps Ltd from low value erosion in the first post merger period to the subsequent periods.

Out of the 46 sample companies, 3 companies (7%) revealed decreasing trend in value addition. Two companies such as Sundram Fastners Ltd and Aventis Pharma Ltd. belonging to this group showed decreasing value addition. TVS Motor Co Ltd. showed positive shareholder value addition from the first to fourth post-merger years and it got reduced and showed value erosion in the fifth year.

The remaining 37 companies (80%) which indicated no influence of merger on shareholder value addition falls under Group III.

MVA AND INTRA-FIRM COMPARISON

Table 3 presents the analysis related to value addition in terms of MVA.

TABLE 3: INTRA-FIRM ANALYSIS WITH MVA

S No	Name of Merged Companies	MVACE (in %) Post Merger Years					Group
		Year 1	Year 2	Year 3	Year 4	Year 5	
1	Aarti Industries Ltd	121.93	158.45	238.20	262.31	238.38	I
2	Abhishek Industries Ltd	31.61	52.14	98.81	177.21	203.62	I
3	ACC Ltd	231.21	254.72	309.13	97.10	121.73	III
4	Andhra Pradesh Paper Mills Ltd	44.16	52.74	70.31	106.26	116.05	I
5	Aurobindo Pharma Ltd	105.20	106.49	151.30	183.14	52.17	III
6	Aventis Pharma Ltd	849.36	612.83	467.87	305.92	290.87	II
7	BASF India Ltd	76.36	104.07	84.68	-21.08	-61.18	III
8	Cadila Healthcare Ltd	230.72	228.09	242.81	195.72	193.88	III
9	Choksi Imaging Ltd	-25.81	94.30	211.10	209.99	177.65	III
10	Deepak Nitrite Ltd	99.79	171.97	182.13	169.45	24.58	III
11	ECO Auto Components Ltd	-6.04	46.06	-254.26	497.58	159.03	III
12	Eveready Industries India Ltd	65.82	-12.70	55.28	42.86	111.58	III
13	Federal-Mogul Goetz (India) Ltd	116.05	163.78	-84.22	73.43	12.26	III
14	Gabriel India Ltd	147.39	203.40	215.91	121.27	496.16	III
15	Gillanders Arbuthnot & Co Ltd	12.02	8.11	30.63	90.15	90.58	III
16	Glaxo Smithline Pharmaceuticals	79.24	209.11	376.46	315.13	312.09	III
17	Granules India Ltd	41.84	84.55	110.54	180.70	97.03	III
18	Grasim Industries	37.83	60.93	92.45	196.01	242.63	I
19	Indian Aluminium Company	72.05	124.67	-198.78	-162.70	-227.53	III
20	Interfit India	-81.00	13.47	26.16	-18.23	-6.22	III
21	Joonktolee & Inds. Ltd	-46.31	-42.77	-39.43	12.04	20.02	III
22	KSB Pumps Ltd	26.92	89.99	115.19	251.16	339.89	I
23	Lakshmi Machine Works Ltd	43.10	190.46	592.01	621.18	523.43	III
24	Lloyds steel inds. Ltd	-173.34	900.20	573.51	9.11	-612.99	III
25	Lloyds Metals and Engineers Ltd	-40.42	-46.72	470.71	27.59	-799.50	III
26	Matrix Laboratories Ltd	116.25	193.98	38.09	-313.18	182.95	III
27	Nagarjuna Fertilizer & Chem. Ltd	63.47	22.32	75.65	50.23	43.97	III
28	North Tukvar Tea Co Ltd	-1.56	14.34	168.85	133.93	47.93	III
29	Novartis India Ltd	86.39	166.49	281.03	102.38	71.73	III
30	Organan (India) Ltd	12.92	92.59	112.84	14.74	19.04	III
31	Pfizer Ltd	104.69	153.40	382.58	451.76	787.63	I
32	Philips Electronics Ltd	123.55	24.38	27.75	9.38	34.55	III
33	Piramal Healthcare Ltd	157.16	268.26	319.65	92.12	120.57	III
34	Polar Industries Ltd	-214.85	112.33	102.92	-70.98	2920.92	III
35	Sagar Cements Ltd	101.14	78.13	454.14	476.36	105.15	III
36	Sandvik Asia Ltd	29.18	117.37	152.40	-14.82	14.52	III
37	Siemens Ltd	331.33	642.24	494.41	292.25	-74.28	III
38	Sun Pharma Inds.Ltd	40.24	156.12	329.97	429.58	459.11	I
39	Sundram Fastners	362.61	425.08	284.73	222.65	183.77	III
40	Tata Steel Limited	228.44	419.64	662.00	452.28	435.18	III
41	Tube Investment Of India Ltd	236.76	416.89	210.53	49.01	53.00	III
42	TVS Electronic Ltd	232.49	12.27	124.61	137.41	104.69	III
43	TVS Motor Co Ltd	239.20	290.46	187.95	73.03	15.42	III
44	Usha International Ltd	47.12	79.25	118.87	154.16	234.44	I
45	Wanbury Ltd	60.83	141.12	135.31	111.91	-139.85	III
46	Wyeth Ltd	40.51	130.19	27.19	190.65	203.91	III

Source: Results computed

GROUP I

As per Table 3, eight companies (17%) indicated an increase in value addition to shareholders in terms of their market's assessment. Companies like Aarti Industries Ltd, Pfizer Ltd., Sun Pharma Industry Ltd., Usha International Ltd., KSB Pumps Ltd., Grasim Industries, Abhishek Industries Ltd., Andrapradesh Paper Mills Ltd., have shown positive value to shareholders which has increased significantly from the first post-merger period to the fifth post merger period.

GROUP II

Aventies pharma Ltd has revealed positive MVA in the first post merger year which reduced subsequently.

GROUP III

This group consists of thirty seven companies (80%) with no effect on market's assessment of company's value thus showing fluctuating trend in the post merger years.

The summary of the results of the intra-firm comparisons carried out with value added metrics is given in Table 4.

TABLE 4: INTRA-FIRM ANALYSIS WITH VALUE ADDED METRICS: SUMMARY RESULTS

Groups	E V A		M V A	
	No. of Co.	%	No. of Co.	%
Group I	6	13.04	8	17.39
Group II	3	6.53	1	2.17
Group III	37	80.43	37	80.44
TOTAL	46	100	46	100

The summary results exhibited in Table 4 indicate that mergers had no effect on shareholder wealth of majority of the selected merged companies, over the five post merger periods.

CONCLUSIONS

The analysis pertaining to value addition carried out in this paper revealed that, as regards intra-firm analysis with EVA and MVA majority of the merged companies (80%) had no definite trend in value addition in terms of EVA and MVA during the post-merger periods. The gainers in value addition in terms of EVA and MVA accounted for 13 and 17 percentage respectively, of the merged companies. Of the gainers, Pfizer Ltd. a pharmaceutical company was the major gainer by way of positive value addition in all the post merger years. TVS Motor Company was the loser by way of value erosion in terms of EVA and substantial fall in MVA in the fifth post merger period.

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