

INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE & MANAGEMENT

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AN EMPIRICAL ANALYSIS OF THE OPERATING PERFORMANCE OF CROSS-BORDER ACQUISITIONS BY INDIAN MULTINATIONALS

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ABSTRACT

The aim of this study is to assess the performance of cross-border acquisitions and their impact on the acquirer firms especially when the target belongs to a developed nation like United States, Italy, Germany, France etc. and the acquirer is from a developing nation like India. Usually its captivating to hear the news of acquisition being announced by an Indian company to acquire ,a US based company because of the esteem attached to the big name of US. This study aims to analyse whether this delight is enjoyed only by the general public or is shared by the owners of the acquiring firms as well in the form of abnormal returns. The study examines whether there is an improvement in the overall financial health of the company after acquisition. Different ratios, growth rates and averages have been used to evaluate financial performance of the sample firms before and after the acquisition. For the said purpose, the Pre and post acquisition financial analysis of 24 sample companies who has done acquisitions during the period of 2000-2005 has been considered.

KEYWORDS

Cross border Acquisitions, Growth analysis, Key ratios, Operating performance.

INTRODUCTION

Until the 1990s, not many Indian companies had contemplated spreading their wings abroad. But after the advent of the Globalization in the early nineties, improved market access, the adoption of the policy of liberalization by countries such as India and the enforcement of some much desired statutes e.g. the Competition Act of India in 2002, Sarbanes Oxley Act in USA etc global mergers and takeovers have become a common visible feature. Across the world low interest rates, pressure of competition and the advent of ever bigger private equity funds have spurred a huge number of mergers and takeovers. In combination with other trends, such as increased deregulation, privatization, and corporate restructuring, globalization has spurred an unprecedented surge in cross-border merger and acquisition activity. With businesses going global, companies in search for a worldwide competitive edge have followed their customers worldwide by way of cross border acquisitions.

OBJECTIVE OF THE STUDY

The aim of this study is to assess the performance of cross-border acquisitions and their impact on the acquirer firms especially when the target belongs to a developed nation like United States, Italy, Germany, France etc. and the acquirer is from a developing nation like India.

HYPOTHESIS OF THE STUDY

For accomplishing the abovesaid purposes the following hypotheses have been formulated.

The null hypothesis : Ho: Pre Acquisition Average and Post Acquisition Average of growth ratios of Indian firms are not significantly different from each other i.e. the growth of acquiring firms have not improved / deteriorated significantly because of the acquisition.

DATA AND METHODOLOGY

The acquisitions during the period 2000-2008 were identified from Thomson ONE Bankers database. A total sample size of 1180 acquisitions were initially accredited with the acquirers being Indian firms and the target nation is a cross-border country. In addition, information about announcement or completion dates and which companies were involved in an acquisition is obtained.

Other criteria used to select the sample are given below:

The deals considered are the ones which were announced, completed and unconditional. Only those acquisitions are analysed in which the target nation is a developed nation. The acquisition deals that lead to effective control of the target company are selected, i.e. this includes 100% acquisitions, majority acquisitions and minority acquisitions in which the bidder previously already acquired part of the target company and with the additions of the latest acquisition the ownership of the target by the bidder is over 50%, resulting in effective control. Sample selected includes only those transactions for which the deal size is at least \$10 million. The target and bidders are not participating in more acquisition deals within the estimation period and testing period. All bidder companies have a BSE (Bombay Stock Exchange) listing.

The data considered for testing the operating performance is for a period of 2000-2005. The data has been restricted till 2005 because we are required to compute three years post acquisition ratios to compare the performance of the acquiring firm with that of the three years pre acquisition ratios. The annual statements for the bidders are collected from the CMIE (Centre for Monitoring Indian Economy) Prowess Database. Finally, the sample size was reduced to 24 Indian acquisition announcements meeting all the above mentioned criteria for the empirical analysis based on financial statements i.e. accounting study.

The method used to assess the impact of acquisition on the acquiring firm in terms of its profitability is measured by calculating the difference in the accounting ratios based on the data extracted from the audited financial statements of the sample firms for pre and post acquisition period of three years each.

According to Grant, Jammine & Thomas (1988) the use of accounting study is justified because:

Managers and external analysts often use return on assets as a measure of the effectiveness and efficiency of top management

The impact of corporate strategy on a firm's performance is more directly reflected in accounting profit than in stock price, which measures investors expectations about future profits.

STEPS FOLLOWED

Firstly, several parameters/ratios for assessing the growth of the sample firms were identified.

These ratios were then calculated by using the data extracted from the CMIE Prowess Database from the financial statements of the selected firms for a period of six years i.e. 3 years pre acquisition and 3 years post acquisition, excluding the year of acquisition. The ratios selected for the study and the formulae used for the computation has been given in the next section.

The acquisition completion year was denoted as year 0. Year 0, the year of the acquisition, is excluded from the analysis for two reasons. First, many of the acquiring firms use the purchase accounting method, implying that in the year of the acquisition the two firms are consolidated for financial reporting purposes from only the date of the acquisition. Results for this year are therefore not comparable across firms or for industry comparisons. Second, year 0 figures are affected by one-time acquisition costs incurred during that year, making it difficult to compare them with results for other years.

These ratios were then averaged for a set of key financial ratios for a period of three years pre and post acquisition and named as pre acquisition average and post acquisition average for the entire set of sample firms, which have done acquisitions during the period 2000 to 2005. The averages computed were the simple arithmetic mean. For all the parameters, for all the sample firms, for a period of 3 years pre and 3 years post acquisition these ratios were computed and then averaged.

Average pre merger and post merger financial performance ratios were then compared to see if there was an increase or decrease in the ratios so computed post acquisition. The companies reporting an increase were assigned a plus sign whereas a minus sign was assigned for a decline.

These differences were then put to test for analyzing any statistically significant change in operating performance due to acquisitions, using "Wilcoxon Signed Ranks Test" i.e. a non-parametric test which does not require any assumption about the distribution of the data used. The analysis has been supplemented by the "T-Test: Paired Two Sample for Means", which is a parametric test just to check the robustness of the results.

GROWTH ANALYSIS

A. Rate of growth-Sales =
$$\frac{\text{Currentyears' sales} - \text{Lastyears' sales}}{\text{Lastyears' sales}} * 100$$

B. Rate of growth-Total Assets =
$$\frac{\text{Currentyears' assets} - \text{Lastyears' assets}}{\text{Lastyears' assets}} * 100$$

C. Rate of growth-PAT =
$$\frac{\text{Currentyears' PAT} - \text{Lastyears' PAT}}{\text{Lastyears' PAT}} * 100$$

D. Rate of growth-Net Worth =
$$\frac{\text{Currentyears' networth} - \text{Lastyears'networth}}{\text{Lastyears'networth}} * 100$$

E. Rate of growth-Capital Employed =
$$\frac{\text{Currentyears' capitalemployed} - \text{Lastyears' capitalemployed}}{\text{Lastyears' capitalemployed}} * 100$$

EMPIRICAL FINDINGS

One of the important objectives behind an acquisition is inorganic growth. The strategic decision like acquisition is usually intended to give a boost to the normal growth figures. The growth analysis for the purpose of the study has been undertaken by calculating growth patterns in several financial variables such as sales, total assets, PAT, networth and capital employed. As earlier stated the study aims at analyzing the impact of acquisition on the operating performance of the business firm particularly for the firms which have acquired the firms from developed nations. With a view to attain the aforesaid objective, it is being tested that whether these acquisitions have resulted in rise in growth rates for the acquirers.

Growth ratios are calculated overtime and they try to capture the relative increase in a particular variable over the prior period. Then these growth rates for the three years prior to acquisition were averaged and compared with the post acquisition average growth rate for the three year post acquisition window.

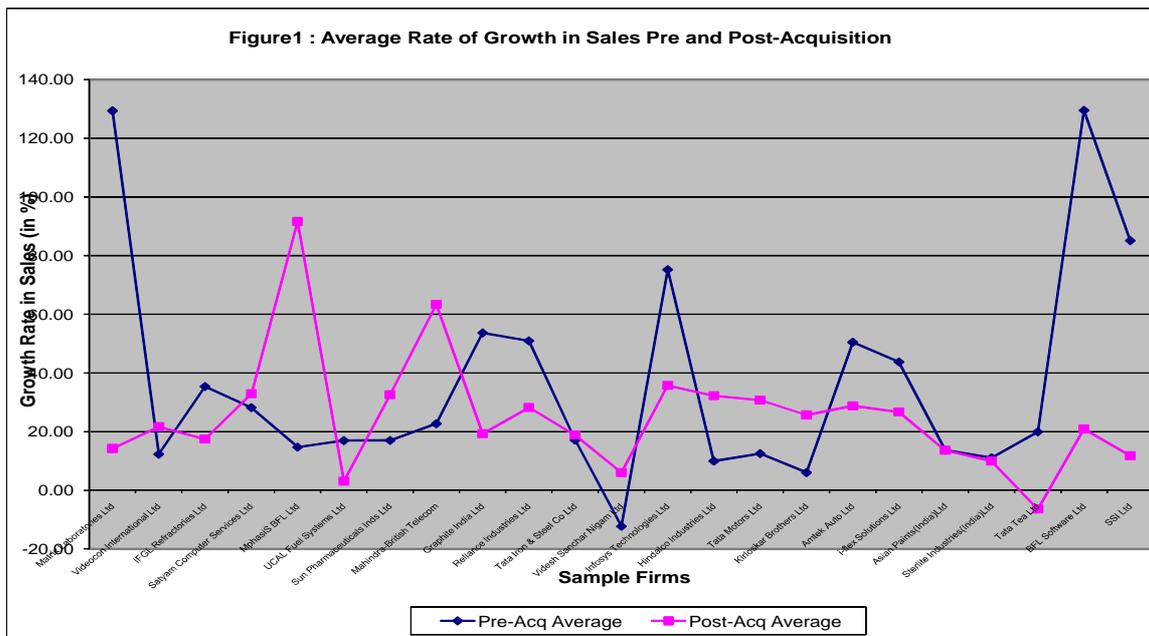
The following reports the summary findings regarding what percentage of companies have reported a decline or an improvement in the average ratios or the financial variables post acquisition. The Table shows the summary results obtained from the application of both the tests carried out on the sample firms i.e. the wilcoxon test and the t-test.

Table: Performance Evaluation:									
PRE AND POST-ACQUISITION PERIOD OF THE SAMPLE COMPANIES,GROWTH PARAMETERS									
S No.	Parameters of Financial Performance	Z-stats (wilcoxon rank test)	p-value	t-stats (paired two sample for means)	p-value	increased after the acquisition		decreased after the acquisition	
						No.of firms	percent (%)	No.of firms	percent (%)
1	Rate of growth-Sales	-0.973	0.330	1.257	0.222	10	43.48	13	56.52
2	Rate of growth-Total Assets	-0.152	0.879	-0.351	0.729	12	52.17	11	47.83
3	Rate of growth-PAT (Profit After Tax)	-0.081	0.935	0.491	0.629	12	54.55	10	45.45
4	Rate of growth-Net Worth	-0.091	0.927	0.113	0.911	12	52.17	11	47.83
5	Rate of growth-Capital Employed	-0.091	0.927	-0.166	0.870	12	52.17	11	47.83

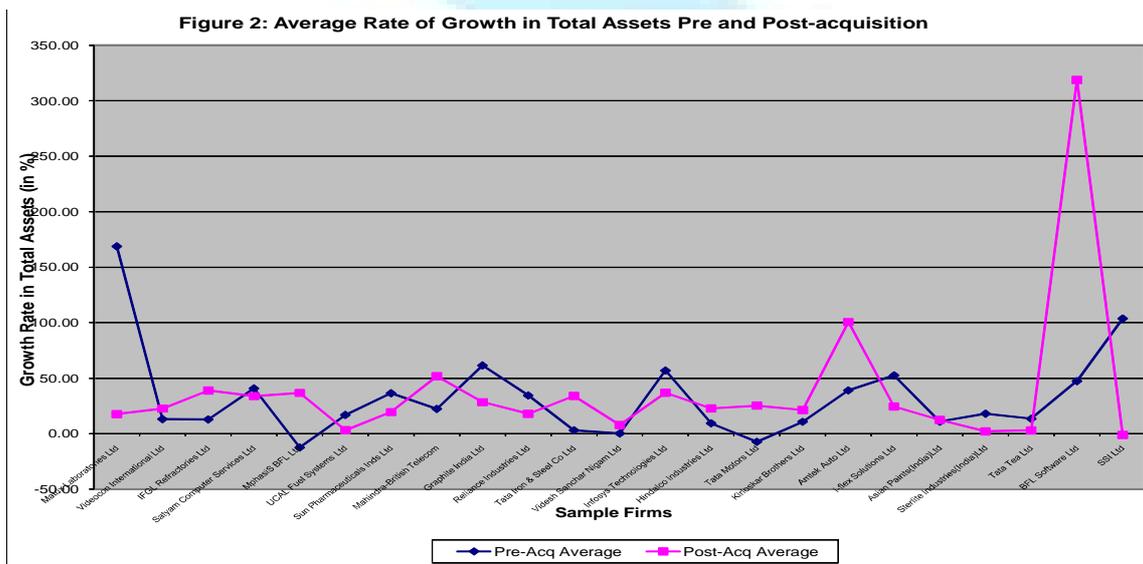
note: 1. # indicates missing value
 2. * significant at 10% Level, ** Significant at 5% Level, *** Significant at 1% Level
 3. figures in parantheses indicates negative values

It can be seen from the table that most firms i.e. more than 50% of the firms have experienced an improvement in the rate of growth in assets, PAT network, capital employed. On the other hand for parameters like, rate of growth in sales, most of the firms have observed a decline.

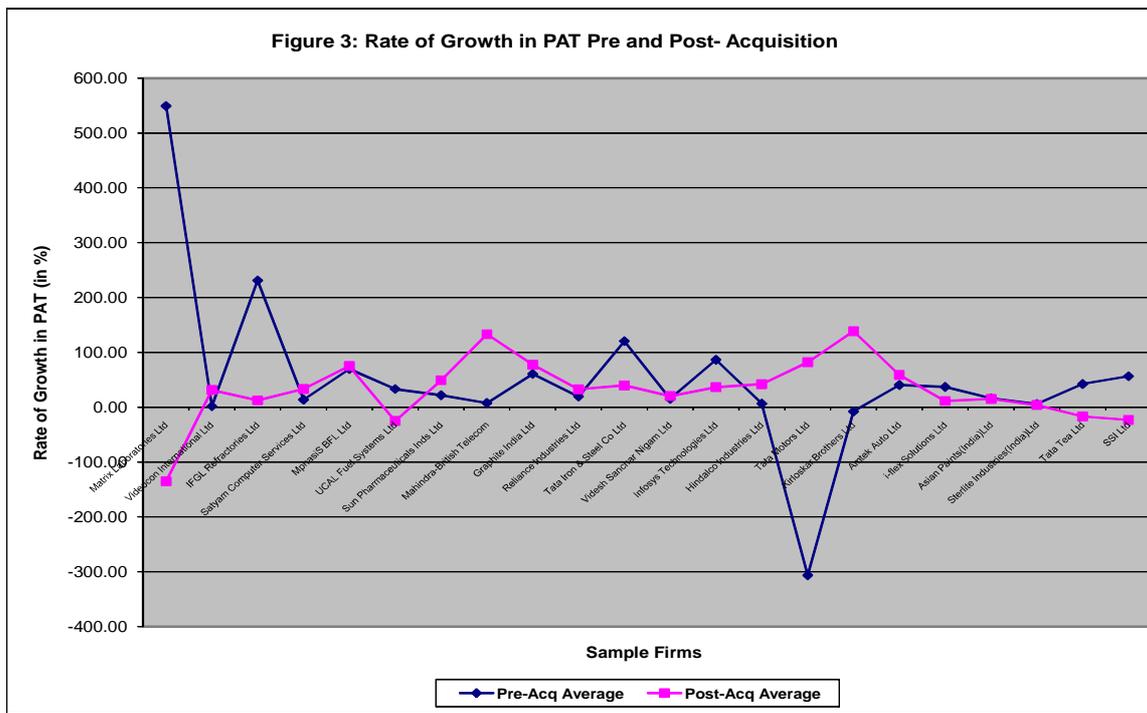
As far as growth analysis is concerned not many companies have shown a significant advancement over a period of three years post acquisition as can be seen from the Figures1 to Figure 5.



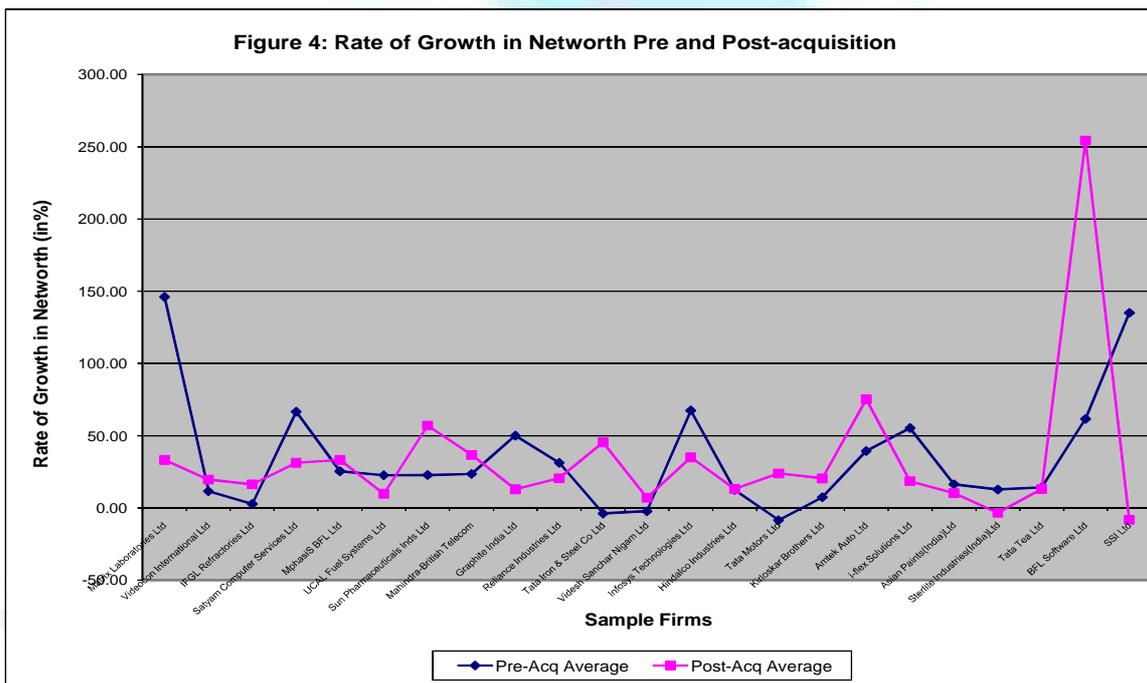
Z-stats (wilcoxon rank test)	-0.973	t-stats (paired two sample for means)	1.257
p-value	0.330	p-value	0.222
No. of firms which has shown an increase percent (%)	10 43.48	No. of firms which has shown decrease percent (%)	13 56.52



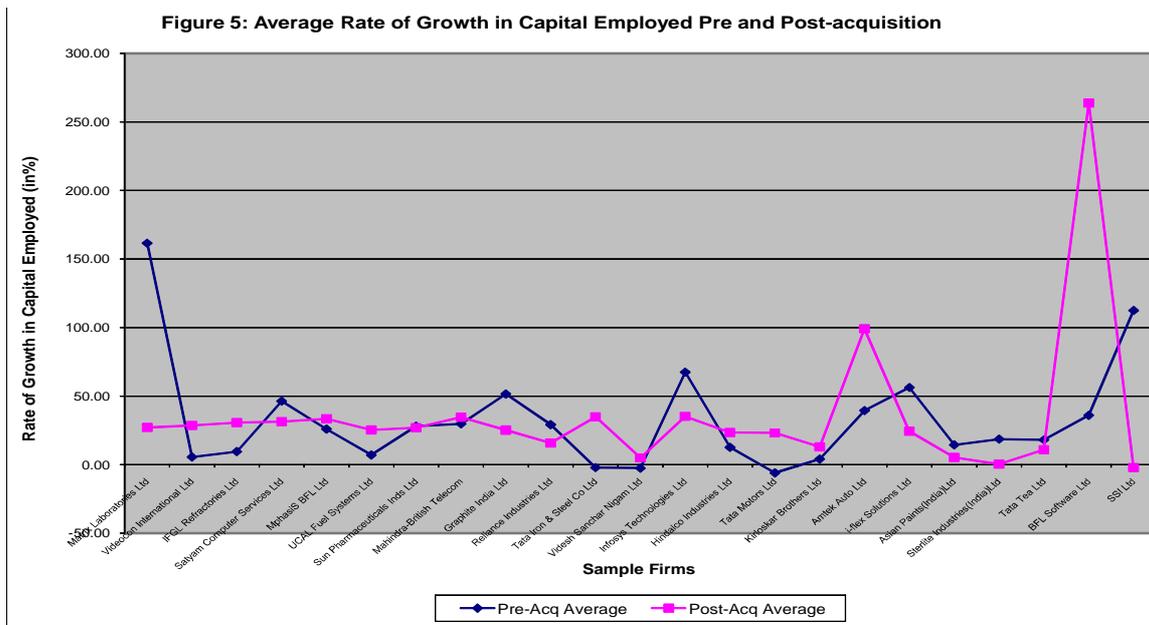
Z-stats (wilcoxon rank test)	-0.152	t-stats (paired two sample for means)	-0.351
p-value	0.879	p-value	0.729
No. of firms which has shown an increase percent (%)	12 52.17	No. of firms which has shown decrease percent (%)	11 47.83



Z-stats (wilcoxon rank test)	-0.081	t-stats (paired two sample for means)	0.490774
p-value	0.935	p-value	0.628676
No. of firms which has shown an increase percent (%)	12	No. of firms which has shown decrease percent (%)	10
	54.55		45.45



Z-stats (wilcoxon rank test)	-0.091	t-stats (paired two sample for means)	0.113
p-value	0.927	p-value	0.911
No. of firms which has shown an increase percent (%)	12	No. of firms which has shown decrease percent (%)	11
	52.17		47.83



Z-stats (wilcoxon rank test)	-0.091	t-stats (paired two sample for means)	-0.166
p-value	0.927	p-value	0.870
No.of firms which has shown an increase percent (%)	12 52.17	No.of firms which has shown decrease percent (%)	11 47.83

Hindalco Industries Ltd. was the only company out of the sample firms reporting a significant ascend in the rate of growth in PAT. On the other hand, IFGL Refractories witnessed a significant descend.

Tata Motors Ltd. was the firm confronting a significant rise if we talk about rate of growth in capital employed, but if we see the trend of growth in network in sample companies then we could have a few firms depicting a significant uptrend. IFGL Refractories Ltd, Sun Pharmaceuticals Inds Ltd, Tata Iron & Steel Co Ltd, Tata Motors Ltd were amongst them.

If we take a look at Figure 2, Average growth rate in total assets have plummeted for almost 48% firms. From figure1 one can see that Hindalco Industries Ltd and Tata Motors Ltd were amongst the few companies had been able to take their growth rate of sales at a higher level. On the other side, UCAL Fuel Systems Ltd. and i-flex Solutions Ltd accounted a significant plunge.

It was surprising to see from figure1 that none of the companies has stated a significant mount in the rate of growth in sales out of the sample firms. Although, there were around 44% firms showing an increase in the said ratio (see Figure 1) but none of them had shown a significant rise. UCAL Fuel Systems Ltd, Amtek Auto Ltd, and i-flex Solutions Ltd were amongst the firms whose rate of growth in sales has plummeted significantly.

CONCLUSION

Given the fact that only limited research has been done previously, despite the fact that India is one of the most active economy of the world in the world of mergers and acquisitions, this study sheds light on the recent abnormal returns of acquisition activity by Indian bidders. The main criterion of the current research was to assess the performance of the acquisition and their impacts on the return to the acquirer firms. The study investigated the Indian market and analyzed the performance of the acquirers between the period January 2000 and December 2008. Some of the financial indicators used in the research were the growth in sales, growth in total assets, growth in capital employed etc. In order to reach a conclusion on the acquisition performance, a comparison of the three year pre- acquisition performance was made with that of the three year post- acquisition performance. As far as growth analysis is considered, the sample firms' growth has not been very promising. Although, the growth for most of the firms has risen but it was not significant. On the whole, on the basis of the sample chosen it would be wrong to articulate that the acquisitions have proven to be a drain on the wealth of acquirers. The measurement of performance in the long run on the basis of the accounting study approach has revealed that neither the announcement returns nor the accounting returns have shown a significant downfall due to the acquisition.

LIMITATIONS OF THE STUDY

The purpose of this section is to be self-critical. The present study has focused on testing the impact on acquirers for indulging into cross border acquisitions in the developed nations by assessing the impact on the accounting figures reported by the firms. However, there are some limitations associated with this study. They are as follows:

The information regarding the target firms in respect of their share prices, financial statements etc. could not be obtained because these belong to several different nations and have their listing in the distinct stock exchanges, this obstructs research to target and combined returns.

Further, as can be observed from the results it becomes clear that the sample is skewed through time in favor of the end of the sample (the later it becomes in time, the more events there are), which raises the question whether this could have influenced the results. Previous literature indicates that the fact that the sample is skewed will not influence the results regarding abnormal returns as Brown and Warner provide evidence in their 1985 paper that clustering of data does not alter the results (Brown and Warner, 1985). Therefore, the results regarding this issue should be robust.

Regarding the control factors different questions can be raised. Not all the control factors mentioned in the literature could be tested in this study because of the lack of data in different cases and time constraints. Control factors that were not included that possibly are of great importance are competition and interlinked with this, bargaining power, the method of payment, relative size of the target, industry relativeness and government influences etc.

DIRECTIONS FOR FUTURE RESEARCH

Generally speaking, more research regarding the merger and acquisition activity in one of the most participating economy of the world, India, is warranted. There are some areas which are suggested for future research which are as follows:

More research is warranted regarding several control factors of abnormal returns that were not incorporated in this research, as data availability was a limiting factor on the side of some control factors in this study. Interesting would be to research whether competition, method of payment, government influence etc. are a factor of influence and what factor of influence (positive or negative) the control variables are regarding to abnormal returns. The selection of the control factors and additional research from this point of view should therefore be an important focal point in future research.

This paper has a focus on the bidder abnormal returns when an acquisition is announced and as a result excludes the possibility to have a closer look at target abnormal returns and combined abnormal returns. In addition, a large portion of target companies are private and therefore no public data is available.

A comparison of the returns earned by the Indian acquirers when they indulge into domestic acquisitions as against the returns being made available to the Indian acquirers if they opt for cross-border acquisition could be investigated. With future research that focuses on the difference between Indian domestic acquisitions compared to Indian acquisitions abroad.

In future research, a comparison could be made between the Indian market and for example the United States market on how quick the announcement effect of an acquisition is incorporated in stock data. Moreover, a research should be performed whether there are differences in abnormal returns between different kind of acquisitions, as the literature regarding research in the United States, for example, tends to yield results that give different results regarding tender offers compared to other forms of acquisitions.

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