Pre and post-merger financial performance: A case study of selected Indian companies

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Abstract

In the present era of global economy, Mergers and Acquisitions have become the most widely used business strategy of corporate restructuring and strengthening to achieve greater market share, long term profitability, entering new markets, capitalizing on economies of scale etc. The effects of M&A on various parameters have already been analyzed by many that yielded mixed results. The present study investigates the effects of mergers and acquisitions on the financial performance of selected companies in India. It details about the net profit margin, return on assets, net interest margin, capital adequacy ratio etc. in the post-merger period. Hence through a pre and post-merger analysis the minute differences in the working efficiency of companies can be studied. The statistical findings of the ten mergers & acquisitions present a very tricky and rosy picture of success and failure. The post-merger impact upon many companies above is a mixture of both positive and negative. The impact of post-merger on Vodafone, Asian Paints and Hindalco has been negative. This implies that while some have managed to synergize the merger and able to integrate respective companies with dynamic leadership and determinism, certain others had to face huge loss due to mounting debt and other operational issues.

KEY WORDS: Pre merger, Post-merger, Financial performance, Profitability ratio, Acquisition.

Growth is the norm in the present times of cut throat competition. A firm can achieve growth either internally by expanding its operations, establishing new units or externally through mergers and acquisitions (M&A), takeover, amalgamations, joint venture etc. With the level of competition getting intense day by day, Mergers and Acquisitions have emerged as the most preferred long term strategy of corporate restructuring and strengthening in the present globalised world. The main rationale behind the Mergers and Acquisitions is to create synergy that is one plus one is more than two.

In today's globalized economy, competitiveness and competitive advantage have become the buzzwords for corporates around the world. Corporates worldwide have been aggressively trying to build new competencies and capabilities, to remain competitive and to grow profitably. In the USA, since the early 1900s, there have been six distinct waves of mergers and acquisitions, each with its distinct characteristics and outcomes, as per a BCG report released in July 2007 1 (based on a detailed analysis of more than 4,000 completed deals between 1992 and 2006 in USA). As per the report, "at the beginning of the twentieth century, there was a drive for market share, followed three decades later by a longer and more ambitious wave as companies connected together different elements of the value chain, from raw materials and production through to distribution. The most recent wave, which started in 2004, after the internet bubble at the turn of the century and the subsequent downturn, is driven by consolidation motives"

In Indian industry, the pace for mergers and acquisitions activity picked up in response to various economic reforms introduced by the Government of India since 1991, in its move towards liberalization and globalization. The Indian economy has undergone a major transformation and structural change following the economic reforms, and "size and competence" have become the focus of business enterprises in India. Indian companies realized the need to grow and expand in businesses that they understood well, to face growing competition; several leading corporates have undertaken restructuring exercises to sell off non-core businesses, and to create stronger presence in their core areas of business interest. Mergers and acquisitions emerged as one of the most effective methods of restructuring, and became an integral part of the long-term business strategy of corporates in India. Over the last decade, mergers and acquisitions in the Indian industry have continuously increased in terms of number of deals and deal value. It is found that Mergers & Acquisitions are a significant form of business strategy today for Indian Corporates.

Statement of the Problem

It is a known fact that in today's scenario a number of mergers and acquisitions are taking place in varied sectors of the economy. Mergers are the combination of two companies to form one, whereas acquisition is one company taken over by the other. M&A is one of the important aspects of corporate finance world. The idea behind M&A is that two companies together create more value compared to being on an individual stand. With the main objective of wealth maximization, companies keep on evaluating different opportunities through the route of mergers and acquisitions. There have been numerous studies undertaken earlier to understand the core idea of M&A and its impact on the financial performance. This study aims to investigate the pre and post-merger financial performance of selected companies belonging to different sectors for a period of 3 years.

Objectives

- To study the pre and post-merger financial performance of selected Indian companies belonging to different industrial sectors.
- To study the operating efficiency of the acquirer after M&A.
- To analyse the impact of M&A with respect to profitability.

Scope of the Study

In the present era of global economy, Mergers and Acquisitions have become the most widely used business strategy of corporate restructuring and strengthening to achieve greater market share, long term profitability, entering new markets, capitalizing on economies of scale etc. The effects of M&A on various parameters have already been analysed by many that yielded mixed results. The present study evaluates the effects of mergers and acquisitions on the financial performance of selected companies in India. It details about the net profit margin, return on assets, net interest margin, capital adequacy ratio etc. in the post-merger period. Hence through a pre and post-merger analysis the minute differences in the working efficiency of companies can be studied.

Research Methodology

The study is purely base on secondary data .The data used for the study is the operating performance ratios up to three years prior and three years after the acquisition year for each acquiring company in the sample. The data was extracted from various sources of concerned companies and from other sources such as money control .com. The researchers had gone through various journals and publications also for peripheral data. The data was analysed by using appropriate statistical tools such as paired sample test

Paired Sample Test:

The paired sample t-test, sometimes called the dependent sample t-test, is a statistical procedure used to determine whether the mean difference between two sets of observations is zero. In a paired sample t-test, each subject or entity is measured twice, resulting in pairs of observations. Common applications of the paired sample t-test include case-control studies or repeated-measures design.

Research Hypothesis

A hypothesis is a proposed explanation about certain behaviours, facts or events that occur or will occur. In other words, it is directed towards explaining the expectations of the results of the study. The hypothesis for the current study is:

H0: There is no significant difference between pre and post-merger financial performances.

H1: There is significant difference between pre and post-merger financial performances.

This study includes the following major mergers and acquisition in India:

TATA STEEL- CORUS GROUP

On January 31, 2007, Tata Steel Limited (Tata Steel), one of the leading steel producers in India, acquired the Anglo Dutch steel producer Corus Group Plc. (Corus) for US$ 12.11 billion (€ 8.5 billion). The process of acquisition concluded only after nine rounds of bidding against the other bidder for Corus - the Brazil based Companhia Siderurgica Nacional (CSN).This acquisition was the biggest overseas acquisition by an Indian company. Tata Steel emerged as the fifth largest steel producer in the world after the acquisition. The acquisition gave Tata Steel access to Corus' strong distribution network in Europe.

VODAFONE – HUTCHISON ESSAR

In July 2011, Vodafone Group bought the mobile phone business of its partner Essar for $5.46 billion. This meant Vodafone owns 74% of Essar. On 11 February 2007, Vodafone agreed to acquire the controlling interest of 67% held by Li Ka Shing Holdings in Hutch-Essar for US$11.1 billion, pipping Reliance Communications, Hinduja Group, and Essar Group, which is the owner of the remaining 33%. The whole company was valued at USD 18.8 billion. The transaction closed on 8 May 2007.

TCS-CMC

Information Technology (IT) sector is the biggest non-farm employer in India. The biggest company in Indian IT sector is Tata Consultancy Services (TCS), it is part of storied Tata Group. CMC Ltd was a subsidiary company of TCS. TCS decided to merge the subsidiary with itself for better operational synergy. The merger was proposed in the financial year 2014-15, and was effected in the financial year 2015-16. CMC shareholders will get 79 equity shares of Re 1 each of TCS for every 100 equity shares of Rs 10 each of CMC.

ICICI-BANK OF RAJASTHAN

ICICI Bank Limited is an Indian multinational banking and financial services company headquartered in Mumbai, Maharashtra with its registered office in Vadodara, Gujarat.

The Bank of Rajasthan Ltd was a private sector bank of India. In 2010, The Bank of Rajasthan (BOR) was acquired by the ICICI Bank in 2010 for Rs.30 billion (US$420 million). RBI was critical of BOR's promoters not reducing their holdings in the company. BOR has since been merged with ICICI Bank. Each 118 shares of BOR will be converted into 25 shares of ICICI Bank.

SUN PHARMACEUTICAL-RANBAXY

Sun Pharmaceuticals and Ranbaxy Laboratories, announced their merger in April 2014, one of the biggest M&A deals in the Indian market, estimated at US$4 billion. Sun Pharmaceuticals will acquire all outstanding shares of Ranbaxy in an all-stock transaction. The shareholders of Ranbaxy will receive 0.8 shares of Sun Pharma for each Ranbaxy share. While at the time of the announcement the deal was expected to close by December 2014, delays in regulatory approvals pushed it to the next year.

Results and discussions

Tata Steel

Table 1

Mean Pre and Post-Merger ratios of Tata Steel

Ratios	Pre-merger (3 years before)	Post-merger (3 years after)	Significance
Operating profit margin	33.78	11.39	0.010
Gross profit margin	29.11	7.91	0.018
Net profit margin	19.01	3.59	0.072
Return on net worth	42.54	18.87	0.244
Return on capital employed	43.88	12.77	0.026
Debt-equity ratio	0.51	2.46	0.032

Source: Author's Analysis

Table 1 shows the mean pre and post-merger ratios of Tata Steel along with the results of the paired sample t-test. The findings of paired sample t-test show a mix merger response on the financial performance. It is noted thatthat the parameters such as Operating profit margin (33.78% to 11.39%), Gross profit margin (29.11% to 7.91%) and Return on capital employed (43.88% to 12.77%), had a decline in the post-merger period and the decline is statistically validated as the calculated t-value is less than critical significance value of 0.05. Similarly, there is a statistically significant increase with respect to Debt equity ratio (0.51 to 2.46). However there appears to be no statistically significant decrease with respect to other parameters such as Net profit margin (19.01% to 3.59%) and Return on net worth (42.54% to 18.87%) as the calculated t-value is greater than standard significance value. Hence, Null hypothesis that there is no significant difference in the pre-merger and post-merger financial performance of Tata Steel is partially rejected.

Vodafone

Table 2

Mean Pre and Post-Merger ratios of Vodafone

Ratios	Pre-merger (3 years before)	Post-merger (3 years after)	Significance
Operating profit margin	34.71	32.02	0.677
Gross profit margin	18.42	20.72	0.797
Net profit margin	-3.29	11.53	0.255
Return on net worth	0.21	15.86	0.468
Return on capital employed	6.46	12.95	0.295
Debt equity ratio	3.25	1.03	0.198

Source: Author's Analysis

Table 2 shows the mean pre and post-merger ratios of Vodafone along with the results of the paired sample t-test. The findings of paired sample t-test show a significant difference in the pre and post-merger financial performance. The researchers found that the parameters such as Operating profit margin (34.71% to 32.02%) and Debt equity ratio (3.25 to 1.03), had a decline in the post-merger period but the decline is not statistically validated as the calculated t-value is greater than critical significance value of 0.05. However other parameters showed an increase in the post-merger period but the increase too is not statistically significant as the calculated t-value is greater than standard significance value. Hence, Null hypothesis that there is no significant difference in the pre-merger and post-merger financial performance of Vodafone cannot be rejected.

TCS

Table 3

Mean Pre and Post-merger ratios of TCS

Ratios	Pre-merger (3 years before)	Post-merger (3 years after)	Significance
Operating profit margin	30.71	29.76	0.685
Gross profit margin	29.01	28.06	0.690
Net profit margin	27.73	26.10	0.089
Return on net worth	41.81	33.02	0.000
Return on capital employed	51.70	41.82	0.007
Debt equity ratio	1.86	0.84	0.051

Source: Author's Analysis

Table 3 shows the mean pre and post-merger ratios of TCS along with the results of the paired sample t-test. The findings of paired sample t-test show a mix merger response on the financial performance. The researchers found that the parameters such as Return on net worth (41.81% to 33.02%), Return on capital employed (43.88% to 12.77%) and Debt equity ratio (1.86 to 0.84), had a decline in the post-merger period and the decline is statistically validated as the calculated t-value is less than critical significance value of 0.05. However there appears to be no statistically significant decrease with respect to other parameters such as Operating profit margin (30.71% to 29.76%), Gross profit margin (29.01% to 28.06%) and Net profit margin (27.73% to 26.10%) as the calculated the t-value is greater than standard significance value. Hence, Null hypothesis that there is no significant difference in the pre-merger and post-merger financial performance of TCS is partially rejected.

ICICI BANK

Table 4

Mean Pre and Post-merger ratios of ICICI Bank

Ratios	Pre-merger (3 years before)	Post-merger (3 years after)	Significance
Operating profit margin	-29.01	-60.35	0.158
Gross profit margin	33.10	85.12	0.021
Net profit margin	8.18	20.58	0.002
Return on net worth	8.91	12.48	0.228
Return on capital employed	13.04	11.81	0.134
Debt equity ratio	9.51	7.09	0.311

Source: Author's Analysis

Table 4 shows the mean pre and post-merger ratios of ICICI Bank along with the results of the paired sample t-test. The findings of paired sample t-test show a mix merger response on the financial performance. It is interesting to note that parameters such as Gross profit margin (33.10% to 85.12%) and Net profit margin (8.18% to 20.58%), had an increase in the post-merger period and the increase is statistically validated as the calculated t-value is less than critical significance value of 0.05 but the increase with respect to Return on net worth (8.91% to 12.48%) is not statistically validated. However there appears to be no statistically significant decrease with respect to other parameters such as Operating profit margin (-29.01% to -60.35%), Return on capital employed (13.04% to 11.81%) and Debt equity ratio (9.51 to 7.09) as the calculated t-value is greater than standard significance value. Hence, Null hypothesis that there is no significant difference in the pre-merger and post-merger financial performance of ICICI Bank is partially rejected.

Sunpharma

Table 5

Mean Pre and Post-merger ratios of Sunpharma

Ratios	Pre-merger (3 years before)	Post-merger (3 years after)	Significance
Operating profit margin	35.82	-3.73	0.058
Gross profit margin	33.33	-10.34	0.059
Net profit margin	36.01	-10.92	0.067
Return on net worth	16.29	-3.86	0.095
Return on capital employed	18.55	-1.50	0.084
Debt equity ratio	0.010	0.243	0.001

Source: Author's Analysis

Table 5 shows the mean pre and post-merger ratios of Supharma along with the results of the paired sample t-test. The findings of paired sample t-test show a mix merger response on the financial performance. The researchers found that the parameters such as Operating profit margin (35.82% to -3.73%) and Gross profit margin (33.33% to -10.34%), had a decline in the post-merger period and the decline is statistically validated as the calculated t-value is less than critical significance value of 0.05. However there appears to be no statistically significant decrease with respect to parameters such as Net profit margin (36.01% to -10.92%), Return on net worth (16.29% to -3.86%) and Return on capital employed (18.55% to -1.50%) as the calculated t-value is greater than standard significance value. There is an increase in the Debt equity ratio (0.010 to 0.243) in the post-merger period but the increase is not statistically validated. Hence, Null hypothesis that there is no significant difference in the pre-merger and post-merger financial performance of Sunpharma is partially rejected.

Findings

- The profitability as well as solvency ratios are insignificant with respect to Vodafone.
- The profitability ratios are insignificant whereas the solvency ratios are significant with respect to TCS,

- The profitability ratios are significant (except Operating profit) whereas the solvency ratios are insignificant with respect to ICICI Bank
- The profitability ratios are significant (except Net profit) whereas the solvency ratios are insignificant (except debt-equity) with respect to Sunpharma.
- The profitability ratios (except Net profit) as well as the solvency ratios (except Return on net worth) are significant with respect to Tata Steel.

Conclusion

The strategy of M&A has been developed over the last 30 years and it has become a highly popular form of corporate strategy to create diversity and growth for an enterprise. The circumstances of every such deal are different and so as the magnitude of impacts as per the deal has been approached, managed and finally executed. Each deal is influenced by various extraneous factors such as company's leadership and the ability of the enterprise to adjust with new set of environment. The success of M&A depends upon how well the deal makers are able to integrate the two companies given its existing strengths and weaknesses. The key to success of a M&A lies in the ability of the acquirer firm to manage the integration of the target company into its existing organization in all respects from winning the hearts and minds of the employees and shareholders, resolving outstanding issues quickly and to eliminate any cultural differences that might arise subsequent to the acquisition. The statistical findings of the ten mergers & acquisitions present a very tricky and rosy picture of success and failure. The post-merger impact upon many companies above is a mixture of both positive and negative. The impact of post-merger on Vodafone, has been negative. This implies that while some have managed to synergize the merger and able to integrate respective companies with dynamic leadership and determinism, certain others had to face huge loss due to mounting debt and other operational issues.

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