Original Research Paper

Volume - 7 | Issue - 7 | July - 2017 | ISSN - 2249-555X | IF : 4.894 | IC Value : 79.96

Management

LONG TERM FINANCIAL PERFORMANCE OF ACQUIRING COMPANIES: EVIDENCES FROM INDIA

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ABSTRACT Mergers and acquisitions have become priority for most of the organizations to enhance their market share in today's highly competitive scenario. Organizations have been investing a large part of their revenue for this pursuit. However, the impact of success in long term depends on series of factors. This study focused on the mergers and acquisitions in India and analyzed the post merger performance of acquiring companies. The study have used data from 2002 to 2015 and compared the performance of companies which have completed acquisition before the financial crisis period, on the financial crisis periods and after the financial crisis period. The researcher selected deals which are completed between 2006 and 2011 and collected financial data up to four years before and after the deal. The study has used the Wilcoxon Ranked Test for analyzing the significant difference between the pre merger performance which have been measured by various financial ratios, and the post merger performance. It is found that acquisitions happened in the financial crisis have gained more than which have merged before the crisis and also after the crisis. The acquisitions after the financial crisis are showing worst performance than the rest two periods.

KEYWORDS : Mergers and Acquisitions, Wilcoxon rank test, financial crisis

1. Introduction

Mergers and acquisitions have become the order of the day across the globe. It is considered as one of the most popular strategic option to enhance the market share (McEntire and Bentley, 1996). A merger is a process of combining two organizations into a single one. In acquisition one organization purchases the other organization or where there is a acquirer who maintains the control (Borys and Jemisons, 1989). Prospective merger or acquisition partners are subject to have mostly strategic fit. Strategic fit is the commonality between organizational strategies setting the base for potential strategic synergy. However, it is intuitive to conclude that strategic fit plays a vital role in the success of merger and acquisition. There are no clear evidence supporting the value of strategic fit in mergers (Chatterje etal.,1992)

In spite of such popularity, it is learnt that 50 – 70 percent of mergers fail to meet their endeavor. (Carleton, 1997) Still the corporate are focusing on Mergers and Acquisitions as a main strategy to get synergy, growth, market share etc. it has been played a vital role in growth and development of the company. The impact of M&A on financial performance is actually a controversial subject. In this paper the researchers focus on Mergers and Acquisitions (M&A) happened between 2006 and 2011. It includes both Domestic and Cross Border Mergers and Acquisitions (CBMA). Literatures say there are number of reasons behind M&As. Synergy (Thanos and Papadakis, 2012); economies of scale (Pangarkar and Lim, 2003); and market share (Sharma and Ho, 2002) are the main driving motives behind almost every M&As. But the reality is there is significant decrease in the financial performance than expected in many M&A deals (Chakrabarti, 1990; Fang et al., 2004; Schweiger and Denisi, 1991). Management decision and resource allocation (Chakrabarti, 1990); nationalistic sentiment (Fang et al., 2004); human aspect of M&As (Ivancevich et al., 1987; Nahavandi and Malekzadeh, 1988); issues at integration level (Schoenberg, 2006) are the main obstacles of M&As. There are also literatures arguing that the M&As can improve the performance.

The study investigates the post merger long term financial performance of acquiring companies after the Acquisitions in India and also analyzed in different deal characteristics.

2. Literature review and Hypothesis

Though many studies have been done in the area of M&As, most of which are done to analyze whether there has been any gain generated after the event. The firm can enhance their performance through economies of scale (Pangarkar and Lim, 2003), synergy (Larsson and Finkelstein, 1999) and market monopoly mainly (Sharma and Ho, 2002). There are studies which depicts that the M&As are not making positive gain (Fang et al., 2004; Schweiger and Denisi, 1991). Mantravadi and Reddy,(2008); Pawaskar, (2001) had explained the reason for decline in profitability in Indian M&As, but Kumar and Bansal (2008) enlightened the profitability improvement especially after M&As.

***H_1*: The Indian firms' M&A in this region has significant impact on its post financial performance.**

2.1. Method of payment

Haleblian et al., (2009); Ghosh, (2001); Linn and Switzer, (2001) opined that the deals which are financed by cash are beneficial than stock financed deals irrespective of its motives. The reason behind this argument is that the manager can use the resources efficiently in cash financed M&As (Jensen,1988). It brings synergetic value due to the faster accomplishment of the deal without costly delay (Berkovitch and Narayanan, 1990).

***H_2*: Cash-financed M&As are likely to impact higher on post financial performance.**

2.2. Industry relatedness

The M&As with in the same industry will make the environment better for the acquiring firms (Haleblian et al., 2009). The literatures gave evidence that the M&As between different industry make poorer performance (Healy et al., 1992; Jensen, 1986). But Ghosh (2001) had opposite opinion on it.

***H_3*: Same-industry M&As are likely to impact higher on post financial performance.**

2.3. Geographic diversification

Internationalization will be favorable for the firm's financial performance (Bertrand and Betschinger, 2012; Erel et al., 2012). It will help in achieving the competitiveness and to get new knowledge (Wang and Boateng (2007) conjecture that. With these advantages the CBMAs will bring synergy and improve financial performance of firms. Gomes et al., (2013) and Kling and Weitzel, (2011) argued that there are number of hindrance to imbed the motives behind the CBMAs. The cultural distance, communication (Gomes et al. 2013); organizational capabilities (Bertrand and Betschinger, 2012); etc are the integration issues. This study focused both on domestic and cross border M&As.

***H_4*: Cross-border deals are likely to increase OP of firms engaged in M&As as compared to domestic deals**

2.4. Crisis

The changes in the business environment have significant impact on the performance of acquiring firms (Beltratti and Paladino, 2013; Rao-

Nicholson and Salaber, 2014). In this study researcher focused on the impact of financial crisis during 2008 about the financial performance of the acquiring firms in India. Crisis will make the company profit down. But it was inferred that during crisis period there are more number of avenues for better opportunities for M&As which will enable to generate better results (Krugman, 2000; Wan and Yiu, 2009).

***H_5*:** *The post financial performance of the acquiring companies is different in the three period viz., pre crisis, during crisis and post crisis.*

3. Data and Methodology

3.1. Sample Selection

This study focuses on both the CBMAs and Domestic M&As deals in India during the period of 2006-2011. The deal details are extracted from the Bloomberg Database; the data include the bidder and target, mode of payment, whether cross border or domestic, the industry relatedness and the time of completion date. The financial service industry is excluded from the list. The acquirers which were not having the accounting data for at least four year before and after the deal are excluded from the sample. The data for the financial performance measurement is taken from the CMIE ProwessIQ database. The researcher collected accounting data up to four year prior and subsequent to each deals. Hence, the deals taken for the study is between 2006 and 2011 and the researcher collected data from the year 2002 to 2015. This process is consistent with the study done by Healy et al., (1992) in the area of performance measures after takeovers.

3.2. Sample Description

Table 1 explains the description of final samples of 326 M&A deals. The Panel A shows the yearly classification of samples; it explains there was a merger wave in the year 2007-2008 (85 deals) and came down in the year 2008-09 (43) Panel B shows the location classification, i.e. the location of the targets. The researcher took 246 CBMAs and 80 Domestic M&As. The panel C shows that the majority of the deals are cash financed deals. The acquisitions in the form of consolidation are 237 i.e. in these deals the target and acquirer are from same industry, and acquisitions in the form of Diversification are 90 i.e. the target and acquirer are from different industry which explained in panel D. The last classification of sample is based on the crisis period. In this study the researcher took 100 deals before the crisis (01/04/2005 to 31/11/2007), 123 deals during the crisis (1/12/2007 to 30/06/2009) and 103 deals after the crisis (1/07/2009 to 31/03/2011) which shown in panel E.

Table 1. Sample Description

	No. of Deals	Percentage		No. of Deals	Percentage
Panel A: Completion Year			**Panel C: Mode Of Payment**		
2005-06	46	14%	Cash	255	78%
2006-07	65	20%	Stock And Cash	71	22%
2007-08	83	25%			
2008-09	43	13%	Panel D: Industry Relatedness		
2009-10	45	14%	Consolidation	237	73%
2010-11	44	13%	Diversification	90	27%
Panel B: Location Of Deals			**Panel E: Financial Crisis**		
Cross Border	246	75%	Pre Crisis	100	31%
Domestic	80	25%	Crisis	123	38%
			Post Crisis	103	31%

Source: Bloomberg Database

3.3. Performance Measurers

The studies are using the accounting measures to evaluate the performance of acquiring companies after the acquisitions (Papadakis and Thanos, 2010; Zollo and Meier 2008; Schoenberg, 2006). The basis for this is relies on the assumption that the companies are going for the restructuring process with the aim of higher performance and the synergy.

The M&A performance is observable in accounting measurers such as ROA (Thanos and Papadakis, 2012; Papadakis and Thanos, 2010), ROCE, RON, CR, QR, and DER over a period of time. Thanos and Papadakis, (2012) explains the use of multiple measures in a study and argued that this will give a holistic approach to the performance.

$$\mathrm{ROA} = \frac{\mathrm{EBIT}}{\mathrm{Assets}}$$

$$\mathrm{ROCE} = \frac{\mathrm{EBIT}}{\mathrm{Capital\ Employed}}$$

$$\mathrm{RON} = \frac{\mathrm{EBIT}}{\mathrm{Networth}}$$

$$\mathrm{CR} = \frac{\mathrm{Curreent\ Assets}}{\mathrm{Current\ Liabilities}}$$

$$\mathrm{QR} = \frac{\mathrm{Corrent\ Assets} - \mathrm{Inventory}}{\mathrm{curent\ Liabilities}}$$

$$\mathrm{DER} = \frac{\mathrm{Total\ Debt}}{\mathrm{Equity}}$$

Where ROA is Return on Asset and EBIT is Earnings before Interest and Tax, Asset is the book value of total assets, ROCE is Return on Capital Employed, Capital Employed is total capital employed used to make the profit, RON is return on Net worth, Net worth is total assets minus total outside liabilities, CR is Current Ratio, Current Asset is total Current Assets, Current Liability is total Current Liability, QR is Quick Ratio, Inventory is total long term inventory, DER is Debt Equity Ratio, Total debt is total amount of Liabilities, Equity is total liabilities subtracted from total assets.

Above said measures are calculated over the period and Wikcoxon Signed Rank test is used to measure whether there any significant change in performance measures after the transaction. The Mann Whitney U test also conducted to analyze whether there any difference between the subgroups regarding the performance.

4. Results and Discussion

Table 2. Descriptive

	MEAN Pre- M&A	MEAN Post-M&A	Mean (Post – Pre)	Std. Deviation (Post – Pre)	Correlation (Post & Pre)
RON	.2226	.1622	-.06044	.19677	.384***
ROCE	.1530	.1171	-.03588	.15694	.553***
ROA	.1010	.0802	-.02078	.08801	.572***
QR	1.7419	1.2534	-.48850	3.99716	.580***
CR	2.2371	1.7863	-.45083	4.07406	.731***
DER	.8383	.9050	.06675	.98650	.558***

*** Significant at 1 % level

The table 2 shows the descriptive statistics and correlation of the pre merger and post merger financial ratios. The result shows there is a significant relationship between pre merger and post merger performance measures. With these results the researcher can go for the Wilcoxon test since the pre merger and post merger ratios are significantly correlated.

Table 3. Changes in Performance

RON	ROCE	ROA	QR	CR	DER
-6.427[a]	-6.377[a]	-6.233[a]	-4.096[a]	-3.646[a]	-2.378[b]

(a)/(b)/© Significance at 1%, 5%, 10% using Wilcoxon ranked test

The table 3 shows the Wilcoxon Z value which used to check whether there are any significant difference in performance measures after the acquisition. It compares the pre merger and post merger financial ratios. It shows there is a significant reduction after acquisition in profitability ratios and liquidity ratios. It means the acquisitions happened in India have significant impact on the post acquisition performance of the acquiring companies.

The profitability, liquidity and leverage ratios show significant reduction after the deals, which indicate that after the acquisitions there will be significant change in the company performance. These results are consistent with the findings of the previous literatures. The study has been conducted only for a period of four year. The gain from the deals can be analyzed with the data of seven or eight year.

Table 4. Deal Characteristics and Change in Performance

	RON	ROCE	ROA	QR	CR	DER
Cross Border	-5.894[a]	-5.760[a]	-5.596[a]	-4.454[a]	-4.337[a]	-2.444[b]
Domestic	-2.705[a]	-2.799[a]	-2.779[a]	-.161	-.523	-.548
Difference(CB-Dom)	-3.189	-2.961	-2.826	**-4.293****	**-3.814****	**-1.896***
Cash	-5.806[a]	-5.693[a]	-5.493[a]	-4.674[a]	-4.534[a]	-2.283[b]
Stock	-2.831[a]	-2.919[a]	-3.000[a]	-.530	-1.120	-.773
Difference (Cash-Stock)	-2.975	-2.774	-2.493	**-4.144****	**-3.414****	**-1.51****
Consolidation	-5.477[a]	-5.405[a]	-5.381[a]	-3.979[a]	-3.596[a]	-2.281[b]
Diversification	-3.378[a]	-3.350[a]	-3.134[a]	-1.264	-1.161	-.843
Difference (Cons-Div)	-2.099	-2.055	-2.247	**-2.715****	**-2.435****	**-1.438****
Pre Crisis	-1.198	-1.377	-1.265	-1.573	-1.857[c]	-.953
Crisis	-5.593[a]	-5.642[a]	-5.776[a]	-3.881[a]	-3.740[a]	-2.783[a]
Post Crisis	-4.358[a]	-3.765[a]	-3.428[a]	-1.432	-.533	-.085
Difference(Post - Crisis)	1.235	1.877	2.348	**2.449****	**3.207****	**2.698****
Difference(Crisis - Pre)	**-4.395****	**-4.265****	**-4.511****	**-2.308****	**-1.883****	**-1.83****

(a)/(b)/© Significance at 1%, 5%, 10% level using Wilcoxon ranked test

**/*Significant at 1%, 5%, levels using Mann Whiteny test

The table 4 shows the changes in performance measures for different deal characteristics or sub groups.

First, the liquidity ratios are significantly affecting after the acquisition in cross border acquisitions, and also the significant change in profitability ratio are more in cross border than domestic even though there is a significant change after acquisition in domestic acquisition. And the difference between the two groups is significant in liquidity ratios. Second, the cash financed acquisitions are affected by the acquisitions more than the stock financed acquisitions, and the group difference are significant in the case of liquidity ratios. Third, the significant changes in the performance ratios are high in the case of consolidation and it is less in diversified acquisitions. But between the groups the liquidity ratios shows the significant difference i.e. after the acquisitions both are performing same except in the liquidity positions. Forth, from the result it is clear that the acquisitions happened in the period of crisis is impacting the performance more than pre and post crisis deals. The group difference between pre crisis and crisis are significant in all the ratios, and between the Crisis and post crisis it is significant for liquidity ratios.

5. Conclusion

The study will contribute in the discipline of M&As by analyzing the post acquisition performance of the Indian companies. From the study it is observed that the M&As are deteriorating the post M&A performance of the acquiring companies. The results are consistent with the literatures (Bertrand and Betschinger, 2012; Fang et al.,2004; Mantravadi and Reddy, 2008). The financial crisis has significant impact on the post M&A financial performance. The cross border M&As are significantly impacted by the event than domestic. The impact of M&A on cash financed deals is more than stock financed deals. The consolidated companies are affected majorly by the M&As. With the results we can infer that the managers should focus on strengthening their capabilities in their core area.

Limitations: This study is not away from the limitations, so it may not give a broad idea about the financial performance. Researcher took only publically listed companies, and also collected data for only four year, so it may not give any comprehensive results.

Further Studies: Further studies can be done by increasing the period of study and classifying in industry basis as well as comparing private and public sectors.

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