“A Comparative Study Of Profitability Position Before And After Mergers And Acquisitions Of The Selected Indian Companies”

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“A COMPARATIVE STUDY OF PROFITABILITY BEFORE AND AFTER MERGERS AND ACQUISITIONS OF THE SELECTED INDIAN COMPANIES”

ABSTRACT

The corporate sector all over the world is restructuring its operations through different types of growth strategies like mergers and acquisitions in order to face challenges posed by the new pattern of globalization, which has led to the greater integration of national and international markets. The intensity of cross-border operations recorded an unprecedented surge since the mid-1990s and the same trend continues. The objective of the study is to analyze and compare the pre and post merger and acquisition profitability position of the selected Indian companies.

For this, the data was being collected is five years before and after the mergers and acquisition from different secondary database like BSE, NSE, annual reports of the firm etc. The study wants to conclude that cross-border Mergers and Acquisitions of the selected firms have resulted in to significant effect on profitability position or not of selected Indian companies.

KEY WORDS:

Cross-Border, Mergers, Acquisitions, Restructuring, Company’s Value creation, Pharmaceutical sector.

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1. INTRODUCTION:

The main objective of any company is profitable growth of enterprise to maximize the wealth of its shareholders. Further, to achieve profitable growth of business it is necessary for any company to limit competition, to gain economies of large scale and increase in income with proportionally less investment, to access foreign market, to achieve diversification and utilize underutilized market opportunities. In order to achieve goals, business needs to remain competitive and work towards its long term sustainability.

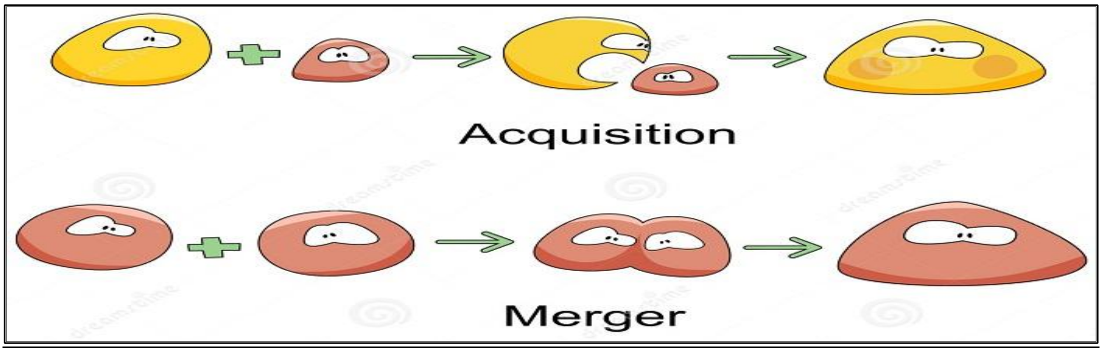
Corporate restructuring has facilitated thousand of companies to re-establish their competitive advantage and respond more quickly and effectively to new opportunities and unexpected challenges. Under different dynamic situations as laid above, a profitable growth of business can achieved successfully if as a strategic tool merger and acquisition is adopted. The most remarkable examples of growth and often the largest increases in stock prices are a result of mergers and acquisitions.

2. CONCEPTS AND DEFINITION OF MERGERS AND ACQUISITIONS (M&A):

M&As are taking place all over the world irrespective of the industry, and therefore, it is necessary to understand the basic concepts pertinent to this activity. The given below (Figure 3) is the clear presentation of the notion of M&A.

Merger is said to occur when two or more companies combine into one company. Merger is defined as a ‘transaction involving two or more companies in the exchange of securities and only one company survives’.

When the shareholders of more than one company, usually two, decide to pool resources of the companies under a common entity it is called **‘merger’**.**Concept of Mergers and Acquisition**



Acquisition is an act of acquiring effective control by a company over the assets (purchase of assets either by lump sum consideration or by item-wise consideration) or management (purchase of stocks/shares or gaining control over Board) of another company without combining their businesses physically.

3. REVIEW OF LITERATURE:

In this study an attempt has been made to briefly review the work already undertaken and methodology employed. A brief review of selected studies has been presented as below:

(1) David C. Cheng (1989), in their paper **'Financial determinants of Bank Takeovers'** found that several studies have examined the determinants of bank merger pricing. Those studies focus on the characteristics of the target and downplay the characteristics of acquirer. Their study found that the purchase price is a negative function of the target's capital to asset ratio. The only variable used in their model is the ratio of acquirer to target assets.

(2) An empirical study entitled **'Takeovers as a strategy of turnaround'** by Ravi Sanker and Rao K.V. (1998) analysis the implications of takeovers from the financial point of view with the help of certain parameters like liquidity, leverage, profitability etc. They observed that a sick company is takeover by a good management and makes serious attempts; it is possible to turnaround successfully.

(3) Ruhani Ali and Gupta G S (1999) in their paper entitled **'Motivation and Outcomes of Malaysian takeovers: An international perspective'** examine the potential motives and effects of corporate takeovers in Malaysia. The Mullar's methodology, which involves the use accounting measures like size, growth, profitability, risk and leverage is employed for the study to analyze the performance characteristics of takeover firms in the pre and post takeovers periods.

(4) Jay Kumar S. (1999) in his dissertation entitled, **‘Mergers and Acquisitions: An Evaluation Study’** examines the relative benefits expected by a corporate enterprise when they adopts mergers and acquisitions as a strategy. The author studies the extent to which the security prices reacted to the announcement of merger.

(5) The working paper **entitled, ‘An analysis of merger in the private corporate sector in India’** by Beena P. L. (2000) attempts to analyze the significance of merger and their characteristics. The paper establishes that acceleration of the merger movement in the early 1990s was accompanied by the dominance of merger between firms belonging to the same business group of houses with similar product line.

(6) The dissertation entitled, **‘An Analysis of Mergers and Acquisitions’** by Canagavally R. (2000), measures the performance in terms of size, growth, profitability and risk of the companies before and after merger. The dissertation also investigates the share prices of sample companies in response to the announcement of merger.

(7) The paper entitled **‘Merger and Acquisition unlocking value’** by Huzifa Husain (2000), explains that takeovers (hostile or non-hostile) may be beneficial to the shareholders if they unlock the hidden value of a company. They also help the existing management to the more receptive to shareholders. Economically, takeovers make sense if the ‘private market value’ of a company is higher than the market capitalization of the company. Further if takeovers are used as a ploy to prevent competition, it becomes harmful to the economy. Therefore, proper checks and balances have to be put in place to ensure that takeover facilitation improves overall efficiency of the economy.

(8) The study entitled, **Trumps for M & A – Information Technology Management in a merger and acquisition strategy** (2001), found that success of merger and acquisitions depends on proper integration of employees, organization culture, IT, products, operations and service of both the companies. Proper IT integration in merger plays a critical role in determining how effectively merged organizations are able to integrate business processes and people, and deliver products and services to both internal and external customers of the organization. The study suggests that to address the challenges, Chief Information Officers should be involved from the earliest phase.

(9) Mr. Surjit Kaur (2002) in her dissertation entitled, **A study of corporate takeovers in India**, examines the M & A activity in India during the post liberalization period. The study tested the usefulness of select financial ratios to predict corporate takeovers in India.

(10) The study entitled '**Mergers and Operating Performance : Indian Experience**' (2007) by Pramod Mantravadi and A. Vidyadhar Reddy, explains that This research study aims to study the impact of m & A 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 mergers between 1991-2003. The result suggests that there are minor variations in terms of impact on operating performance following merger in different intervals of time in India.

4. RESEARCH METHODOLOGY:

4.1 TITLE OF THE PROBLEM :-

Mergers take place due to various motives. There for an analysis has to be made to compare the financial performance of pre and post merger of the firms. The title of the problem is as under:

"A Comparative Study of Profitability Before and After Mergers and Acquisitions of the selected Indian Companies."

4.2 OBJECTIVES OF THE STUDY:

The broad objective of this study is to examine and evaluate the impact of mergers and acquisitions on the profitability position of the selected companies by some important parameters of profitability Measurement Ratios such as:-

- To examine and evaluate the impact of mergers and acquisitions on Operating Profit Margin Ratio
- To examine and evaluate the impact of mergers and acquisitions on Gross Profit Margin Ratio
- To examine and evaluate the impact of mergers and acquisitions on Net Profit Margin Ratio

4.3 RESEARCH DESIGN:

The Comparative study of Profitability performance before and after the merger and acquisition of the selected corporate sectors is totally based on the Secondary Data of the

Financial Statements of the Company. That's why **Descriptive Research Design** is used for the current research study.

4.4 POPULATION OF THE STUDY:

The population of the study consists of all types of the **Indian companies** having any types of different operations of business and totally different nature of industries but having any Merger and Acquisition Deals in Indian corporate sectors.

4.5 SELECTION OF SAMPLES:

The study has been carried out on the micro-level, as it is not possible for the researcher to conduct it on the macro-level. The population of the study consists of all types of the companies having different operations of business and totally different nature of industries. As the study is to be carried out by the individual researcher it is not easy to select all the companies as the samples for the study. So, the **convenient random sampling** has been done. As such the universe of the study is Indian Industries; the researcher has selected 10 companies (Which are top ten mergers and acquisitions (as per the Deal Value) during the year 2006 to 2011) as mentioned below:

Sample Companies

SR NO	TOP 10 MERGER & ACQUISITIONS DEALS (DURING THE YEAR 2006 TO 2011)	VALUE	YEAR	INDIAN COMPANY (Sample for the research)
1	Tata Steel-Corus	$12.2 billion	Jan, 2007	**TATA STEEL LTD**
2	Vodafone-Hutchison Essar	$11.1 billion	Feb, 2007	**HUTCHISON ESSAR**
3	Hindalco-Novelis	$6 billion	Feb, 2007	**HINDALCO INDUSTRIES LTD.**
4	Ranbaxy-Daiichi Sankyo	$4.5 billion	Jun, 2008	**RANBAXY LABORATORIES LTD.**
5	ONGC-Imperial Energy	$2.8 billion	Jan, 2009	**OIL AND NATURAL GAS CORPORATION LTD. (ONGC)**
6	NTT DoCoMo-Tata Tele	$2.7 billion	Nov, 2008	**TATA TELESERVICES LTD.**
7	HDFC Bank-Centurion Bank of Punjab	$2.4 billion	Feb, 2008	**HDFC BANK**
8	Tata Motors-Jaguar Land Rover	$2.3 billion	Mar, 2008	**TATA MOTORS**

9	Sterlite-Asarco	$1.8 billion	May, 2008	**STERLITE INDUSTRIES**
10	Suzlon-RePower:	$1.7 billion	May, 2007	**SUZLON ENERGY LTD.**

4.6 DATA COLLECTION:

The study is based on the **secondary data** taken from the annual reports of selected units and EMIS data base website. And all the data relating to history, growth and development of Industries have been collected mainly from the books and magazine relating to the industry and published paper, report, article. The data relating to the selected units under study have been obtained from prospectus, pamphlets and annual reports of the selected units.

4.7 PERIOD OF THE STUDY:

The present study is mainly intended to examine the profitability position of merged and acquirer or acquired Indian companies five years before merger and acquisition and five years after merger and acquisition.

5. HYPOTHESIS OF THE STUDY:

On the basis of data collection, the following are the hypothesis for the study:

• **NULL HYPOTHESIS: -**

1) There would be no significant difference in means score of Operating Profit Margin Ratio in selected units, before and after merger and acquisition.

2) There would be no significant difference in means score of Gross Profit Margin Ratio in selected units, before and after merger and acquisition.

3) There would be no significant difference in means score of Net Profit Margin Ratio in selected units, before and after merger and acquisition.

• **ALTERNATE HYPOTHESIS: -**

1) There would be significant difference in means score of Operating Profit Margin Ratio in selected units, before and after merger and acquisition.

2) There would be significant difference in means score of Gross Profit Margin Ratio in selected units, before and after merger and acquisition.

3) There would be significant difference in means score of Net Profit Margin Ratio in selected units, before and after merger and acquisition.

5.1 TOOLS OF DATA ANALYSIS:

5.1.1 Ratio Analysis:

Ratios are among the well known and most widely used tools of financial analysis. Ratio can be defined as "The indicated quotient of two mathematical expression".**1** An operational definition of ratio is the relationship between one item to another expressed in simple mathematical form.

5.1.2 Statistical Techniques:

(i) Average:

The most commonly used average is the arithmetic mean, briefly referred to as the mean. The mean can be found by adding all the variables and dividing it by total number of years taken. It gives a brief picture of a large group, which it represents and gives a basic of comparison with other groups.**2**

(ii) The Standard Deviation:

The standard deviation concept was introduced by **Karl – Pearson** in 1823. It is by far the most important and widely used measure of studying Dispersion. Standard Deviation is also known as root mean square deviation for the reason that it is the square root of the mean of the squared deviation from arithmetic mean. Standard deviation is denoted by small Greek letter "σ".

(iii) T-Test:

T – Test is based on T – Distribution and is considering an appropriate test for judging the significance of a sample mean. It can also be used for judging, the significance of the coefficients of simple and partial correlations. The relevant test statistic, is calculated from the sample data and then compared with its problem value based on T – distribution at a specified level of significance for concerning degrees of freedom for accepting or rejecting the Null Hypothesis.

6. SIGNIFICANCE OF THE STUDY:

6.1 Contribution to the knowledge: -

- Through this study my knowledge particularly regarding various ratios will be improved.
- Through this study my knowledge particularly regarding various statistical tools and techniques and statistical tests is improved.
- My analytical power will be improved.

6.2 Contribution to the society: -

- Through this research society will be able to know the real situation of the profitability position, of selected units, before and after merger and acquisition.

- Through this study creditors and other parties can take proper decision.

- Employees will be able to take proper decision regarding job (work).

6.3 Contribution to the Industry: -

- Industry may be able to maintain their Profitability position during post merger and acquisition.

- Industry may be able to know the impact of mergers and acquisitions on their profitability position.

7. LIMITATION OF THE STUDY:

The major limitations of this study are as under:

1. This study is mainly based on secondary data derived from the annual reports of industry. The reliability and the finding are contingent upon the data published in annual report.

2. There are many approaches for evaluation of Profitability. There are no common views among experts.

3. The study is limited to five years before merger and five years after merger only.

4. Accounting ratios have its own limitation, which also applied to the study.

5. Inflation plays vital role in Indian Economy. If we do not considered inflation, when analysis of financial condition, is studied, evaluation may be not truly representative. In this study the effect of inflation is not considered which its limitation becomes.

6. This study is related with ten units. Any generalization for universal application cannot be applied here.

7. Profitability analysis does not consider those facts which cannot be expressed in terms of money, for example – efficiency of workers, reputation and prestige of the management.

8. DATA ANALYSIS AND INTERPRETATIONS:

8.1 OPERATING PROFIT RATIO:

This ratio indicates the relationship between operating profit and net sales. Operating cost is the total cost of goods sold and all other operating expenses. i.e. administrative expenses and selling and distribution expenses. Operating profit ratio is calculated on the basis of following formula:

Operating Profit Ratio= $\frac{\text{Operating profit (EBIT)}}{\text{Net Sales}}$ X 100

TABLE 8.1
Operating Profit Ratio in selected units
(Before 5 years and after 5 years of M & A)

Sr. No.	**Name of the compny**	**Before M & A**	**After M & A**	***Diff* (T2 - T1)**	***Dev* (Diff - M)**	***Sq. Dev***
1	TATA STEEL LTD	33.783	11.522	-22.26	-25.16	632.96
2	HUTCHISON ESSAR	-47.99	20.044	68.03	65.14	4242.78
3	HINDALCO INDUSTRIES LTD.	23.857	10.76	-13.1	-15.99	255.81
4	RANBAXY LABORATORIES LTD.	12.153	13.33	1.18	-1.72	2.96
5	OILAND NATURAL GASCORPORATION LTD. (ONGC)	43.605	38.742	-4.86	-7.76	60.22
6	TATA TELESERVICES LTD.	7.57	19.722	12.15	9.25	85.65
7	HDFC BANK	20.56	26.21	5.65	2.75	7.58
8	TATA MOTORS	12.75	10.524	-2.23	-5.12	26.25
9	STERLITE INDUSTRIES	27.635	24.65	-2.98	-5.88	34.6
10	SUZLON ENERGY LTD.	21.59	8.982	-12.61	-15.51	240.42
				M: 2.90		**S: 5589.22**

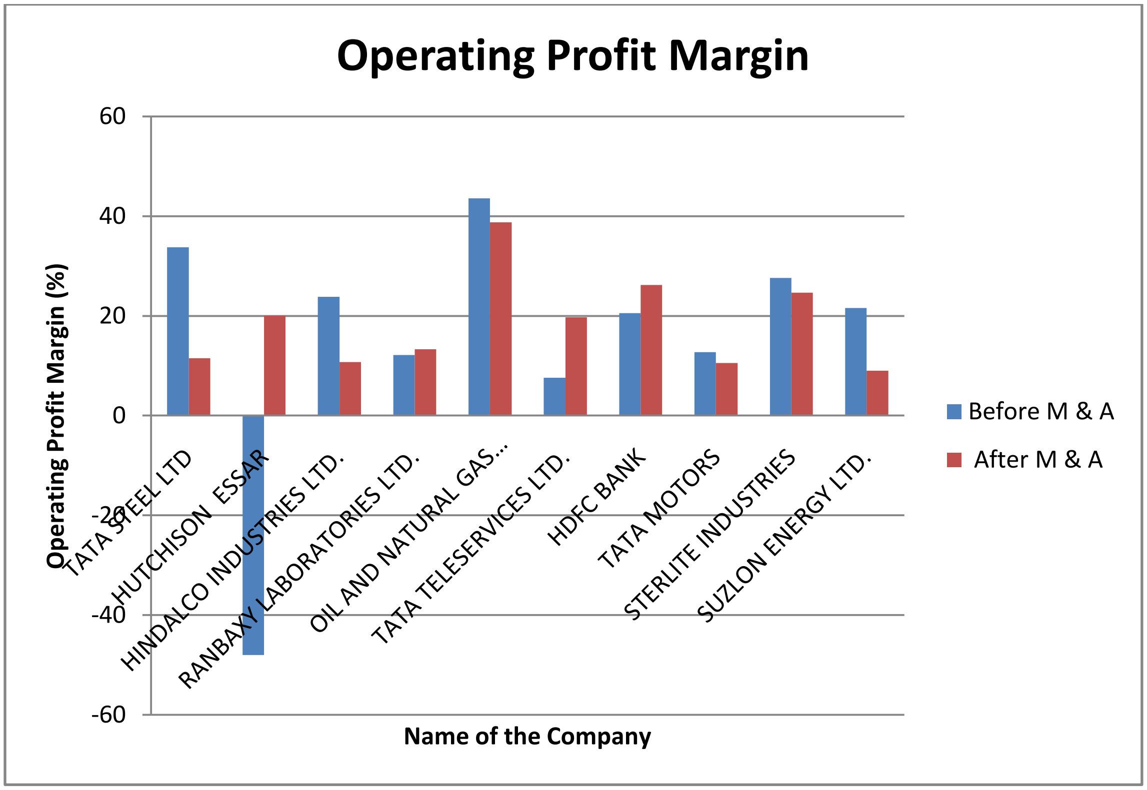
(**Source:** Annual reports of the selected units and EMIS database website.)

Analysis :

The table no. 8.1 shows the operating profit ratio in selected units before and after mergers and acquisitions. The ONGC shows the highest % 43.605 and the Hutchison Essar Shows the lowest % -47.99 before mergers and acquisitions. And remaining units show an average operating profit ratio, before mergers and acquisitions. After mergers and acquisitions Hutchison Essar, Ranbaxy, TATA tele services and HDFC bank shows the increase in Operating profit margin

So, we can conclude that, the profitability of 4 units is increased and 6 units are decreased after mergers and acquisitions.

Chart:



Calculation of T-Test :

Difference Scores Calculations

$$Mean: 2.90$$

$$\mu = 0$$

$$S^2 = SS/df = 5589.22/(10-1) = 621.02$$

$$S^2_M = S^2/N = 621.02/10 = 62.10$$

$$S_M = \sqrt{S^2_M} = \sqrt{62.10} = 7.88$$

T-value Calculation

$$t = (M - \mu)/S_M = (2.90 - 0)/7.88 = 0.37$$

H0 = There would be no significant difference in means score of Operating Profit ratio in selected units, before and after merger and acquisition.

H1 = There would be significant difference in means score of Operating Profit ratio in selected units, before and after merger and acquisition.

$$H0 = u1 = u2$$

$$H1 = u1 \neq u2$$

5% level of significance table value of t = 2.262

The calculated value of T is 0.37 and table value of T is 2.262(at 5% level of significance). Hence,

$$TC < TT$$

The calculated value of 't' is less than the table value. The Null Hypothesis is accepted. The results are as per the expectation.

8.2 GROSS PROFIT MARGIN RATIO:

Gross profit ratio shows relationship of gross profit to net sales. Gross profit is arrived at by deducting cost of goods sold from net sales. Expenses generally charged to profit and loss account are not included in the cost of goods sold.

This is obtained by dividing the amount of gross profit by sales and is expressed as a percentage. Gross profit ratio is expressed as follows:

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit X 100}}{\text{Net Sales}}$$

TABLE 8.2
Gross Profit Ratio in selected units
(Before 5 years and after 5 years of M & A)

Sr. No.	Name of the compny	Before M & A	After M & A	*Diff* (T2 - T1)	*Dev* (Diff - M)	*Sq. Dev*
1	TATA STEEL LTD	29.106666	8.012	-21.09	-15.57	242.37
2	HUTCHISON ESSAR	41.84	34.794	-7.05	-1.52	2.31
3	HINDALCO INDUSTRIES LTD.	17.466666	6.626	-10.84	-5.31	28.24
4	RANBAXY LABORATORIES LTD.	9.95	9.392	-0.56	4.97	24.69
5	OIL AND NATURAL GAS CORPORATION LTD. (ONGC)	29.1775	28.04	-1.13	4.39	19.3
6	TATA TELESERVICES LTD.	-3.518	-4.948	-1.43	4.1	16.78
7	HDFC BANK	17.71	23.848	6.14	11.66	136.06

8	TATA MOTORS	10.105	6.732	-3.37	2.15	4.64
9	STERLITE INDUSTRIES	23.56	21.1	-2.46	3.06	9.37
10	SUZLON ENERGY LTD.	19.593333	6.132	-13.46	-7.93	62.96
				M: -5.53		S: 546.72

(**Source:** Annual reports of the selected units and EMIS database website.)

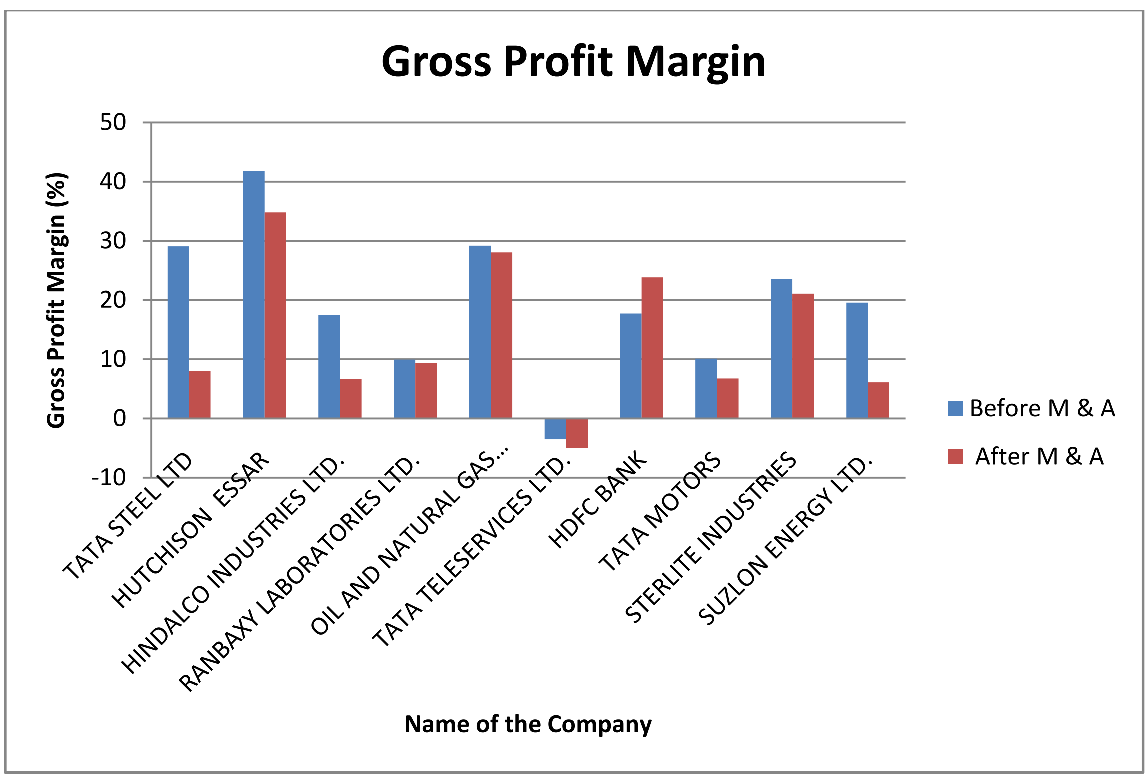
Analysis :

The above table no. 8.2 indicates the gross profit ratio in selected units, before and after merger and acquisitions. Moreover, Hutchison Essar shows the highest % 41.84 and TATA teleservices shows lowest ratio of -3.518% and rest of the industry shows an average gross profit ratio before mergers and acquisitions.

Besides this, after mergers and acquisitions the performance of HDFC bank is increasing and rest of all decreasing.

So, we can conclude that after mergers and acquisitions the financial performance of sample units was not improved.

Chart :



Calculation of T – Test:-

Difference Scores Calculations

$$\textit{Mean}: -5.53$$

$$\mu = 0$$

$$S^2 = SS/df = 546.72/(10-1) = 60.75$$

$$S^2_M = S^2/N = 60.75/10 = 6.07$$

$$S_M = \sqrt{S^2_M} = \sqrt{6.07} = 2.46$$

T-value Calculation

$$t = (M - \mu)/S_M = (-5.53 - 0)/2.46 = -2.24$$

H0 = There would be no significant difference in means score of Gross Profit ratio in selected units, before and after merger and acquisition.

H1 = There would be significant difference in means score of Gross Profit ratio in selected units, before and after merger and acquisition.

$$H0 = u1 = u2$$

$$H1 = u1 \neq u2$$

5% level of significance table value = 2.262

The calculated value of T is -2.24 and table value of T is 2.262(at 5% level of significance). Hence,

$$TC < TT$$

The calculated value of 't' is less than the table value. The Null Hypothesis is accepted. The results are as per the expectation.

8.3 NET PROFIT RATIO :

This ratio indicates the portion of sales which is left to the proprietor after all costs, charges and expenses have been deducted. This is ratio of net income or profit after taxes to sales. The ratio is very used a measure of overall profitability. Net profit ratio focuses on the non-operating activities. Net profit ratio is calculated on the basis of following formula,

$$\text{Net Profit Ratio} = \frac{\text{Net Profit X 100}}{\text{Sales}}$$

<u>TABLE 8.3</u>

<u>Net Profit Ratio in selected units</u>

(Before 5 years and after 5 years of M & A)

Sr. No .	**Name of the compny**	**Before M & A**	**After M & A**	***Diff* (T2 - T1)**	***Dev* (Diff - M)**	***Sq. Dev***
1	TATA STEEL LTD	18.81	4.47	-14.34	-18.43	339.82
2	HUTCHISON ESSAR	-47.99	15.616	63.61	59.51	3541.67
3	HINDALCO INDUSTRIES LTD.	12.3466 6667	3.724	-8.62	-12.72	161.72
4	RANBAXY LABORATORIES LTD.	9.3575	-1.604	-10.96	-15.06	226.67
5	OIL AND NATURAL GAS CORPORATION LTD. (ONGC)	20.4	16.806	-3.59	-7.69	59.11
6	TATA TELESERVICES LTD.	-46.31	-12.85	33.46	29.37	862.59
7	HDFC BANK	14.82	16.122	1.3	-2.79	7.8
8	TATA MOTORS	6.89	4.048	-2.84	-6.94	48.11
9	STERLITE INDUSTRIES	11.82	14.145	2.32	-1.77	3.13
10	SUZLON ENERGY LTD.	18.21	-1.186	-19.4	-23.49	551.78
				M: 4.09		**S: 5802.39**

(**Source:** Annual reports of the selected units and EMIS database website.)

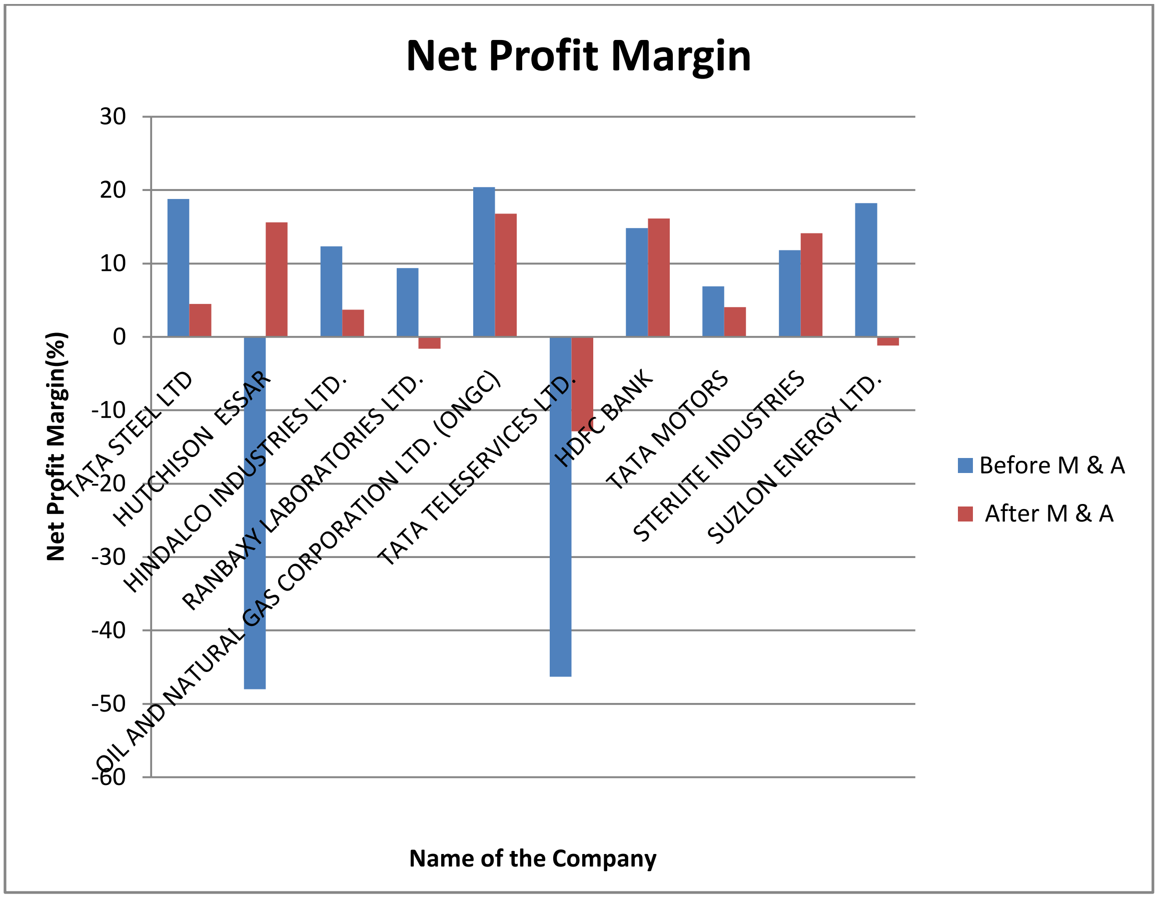
Analysis :

The table no. 8.3 shows the data regarding net profit ratio in selected 10 units during before and after mergers and acquisitions. The ONGC shows the highest % 20.4 and Huchison Essar Shows the lowest % -47.99 before mergers and acquisitions. And remaining units show an average net profit ratio, before mergers and acquisitions.

After mergers and acquisitions ONGC shows the highest and TATA tele services shows lowest Net Profit Ratios

We can conclude that after mergers and acquisitions the financial performance of some selected units were improved and some were not improved.

Chart:



Calculation of T – Test:-

Difference Scores Calculations

Mean: 4.09

$\mu = 0$

$S^2 = SS/df = 5802.39/(10-1) = 644.71$

$S^2_M = S^2/N = 644.71/10 = 64.47$

$S_M = \sqrt{S^2_M} = \sqrt{64.47} = 8.03$

T-value Calculation

$t = (M - \mu)/S_M = (4.09 - 0)/8.03 = 0.51$

H_0 = There would be no significant difference in means score of Net *Profit ratio in selected units, before and after merger and acquisition.*

H_1 = There would be significant difference in means score of Net Profit ratio in selected units, before and after merger and acquisition.

$$H0 = u1 = u2$$

$$H1 = u1 \neq u2$$

5% level of significance table value = 2.262

The calculated value of T is 0.51 and table value of T is 2.262(at 5% level of significance). Hence,

$$TC < TT$$

The calculated value of 't' is less than the table value. The Null Hypothesis is accepted. The results are as per the expectation.

9. CONCLUSION:

It is evident from the above analysis that all three hypotheses are fully accepted. The conclusion emerging from the point of view regarding Profitability position is that the merging companies were generally merged with objective of Maximize the Profitability of both the companies But from the above results of T-test, we can conclude that most of time we found adverse situations.

However it should be tested with a bigger sample size and more no of years before coming to a final conclusion.

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