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A study on Acquisition Motives of Indian Acquiring Companies and its post merger performance

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Abstract - This study analyses the objectives of acquisitions of companies during the study period of 2010-11 to 2014-15. The industry classification is also studied about the sample. Further on the study also compares the pre and post acquisition performance of these companies using profitability ratios- RONW, ROCE, ROTA and NPM. Paired sample t test have been applied to measure the pre and post merger performance. It reveals that diversification and synergy are the most important objective of acquisition for the selected sample. The most number of companies that have acquired are from computer software and steel industry. The statistical tests results reveals that acquisitions have failed to bring positive impact on the acquiring firms

Key words: mergers and acquisitions, profitability ratios, synergy, diversification

I. INTRODUCTION

Over the years, Mergers and acquisitions have viewed as the tool for attaining corporate growth. It is believed that M &A helps in creating wealth to the shareholders. Hence it has become the most important strategic tool for growth by companies throughout the world. It also helps in achieving competitive advantage. In today's globalised and dynamic environment the use of M & As for the purpose of growth is on an increase. M & A activities help the companies in achieving competitive position and also being the market leader. It also helps in attaining market share and also conquering different geographical markets worldwide. The year 2007 was considered to be the year of major deals globally in which the deal value crossed US$ 4.7 trillion. The total value of deals in India was US $ 67 million. The history of M&A can be traced back to 1895 when the first incident of M & A was believed to have taken place in the United States of America. This is known as the first wave of M&A activity. This was followed by five more waves of M&A activities with different types of motives behind it. The first wave started in the year 1895 and lasted till 1904. This was known as the wave of horizontal mergers. The second wave was known as the wave of vertical mergers which started in the year 1916 and lasted till 1929. The third wave started in the year 1965 which was known as the wave for conglomerate mergers. This wave lasted till 1969. The third wave was known as hostile takeovers which started 1981 and lasted till 1989. In the fifth wave the majority deals were cross border mergers. The fifth wave started in 1990 and lasted till 2000. The last wave started in 2003 and is continuing till now. Majority of deals the in this wave is of leveraged buyouts and private equity.

In India, the wave of M &A started in its strong form only after the 1990,s liberalization process of Indian economy. This is when the Indian economy introduced liberalization, privatization and globalization. Even though M & A was considered it was not used up more extensively till the late 1990s. In India M & A was used as a method of saving a company from closure. In this period M & A was extensively used in the financial sector. Banks were formed together to create bigger and larger banks. Later on it started gaining momentum in all industries of the country. Latest trend in Indian M & A activities have been cross border deals. It is undertaken to attain market leadership and expanding geographical market. M & A activities started gaining momentum by the year 2000 in India. By then the regulatory policies in the countries had also changed in favour of promoting M & A activities in the country.

II. LITERATURE REVIEW

There are immense studies in the area of mergers and acquisitions worldwide. The studies have been undertaken mostly to find out the impact of deals on the performance of the companies involved. The performance of both target and acquirer companies have been studied. (Bradley et.al. 1983, Mulherin and Boone 2000, Moeller and Schlingemam 2005, Pettaway et al 1990). Nevertheless most number of studies focuses on the performance of acquirer companies. A study in the UK (Manson 2000) used 44 deals in the country to analyse the performance of the acquiring companies. The operating performance was measured for which the cash flow of the companies were used. Yet another study by Thambi 2005 used accounting measures for ascertaining the impact of M & A on the performance of acquiring companies.

Mantravadi & Reddy(2008), investigated the impact of mergers on the companies that acquired during 1991-2003. The pre and post acquisition financial ratios were used to analyse the performance. It revealed that there is a small

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variation in the performance of companies involved pre and post the event.Trivedi (2013), studied the impact of pre and post merger performance of the top BSE and NSE companies. Financial ratios were again used for the purpose of identifying any differences pre and post merger performance. Majority of the ratios used showed a performance improvement. Whereas some ratios did not change. But altogether he suggests that there is an improvement in the performance. Hannan & Pilloff (2006), using a large sample of mergers in banking industry during the period of 1996 to 2005 analysed the characteristics of the target firms that made them as a preferred option for acquisition. It was revealed that the banking firms which are less efficient are becoming the targets for acquisitions.

In spite of having an extensive research in this area the result of the studies altogether gives a mixed indication of performance. Some studies like Healy et.al (1990), Mann & Kohli (2009), Rakshit (2008).Kumar & Rajib (2007) are of the indication that Mergers have been successful in bringing some change into the performance of companies involved. There are studies conducted in this area where results indicates a performance decline in the firms involved. Fowler and Schmidt (1986), Datta et al. (1992), (Martynova et al. (2006), Zhu and Malhotra King et al. (2008) are some studies that indicates a performance decline. The types of the deal are also having an impact on the performance of the acquiring firms. Kusewitt (1985), Morck et al. (1990), Healy et.al.(1997), Vermaelen, (1998) are some studies that suggest the importance oftype of deals in measuring performance

Similarly the motives for merger has also been studied and documented. (Bradley et al. 1983, Dennis & Mconnel 1986, Trautwein 1990, and Yook 2003.)

III. Objective

The objective of this study is:

1. To analyse the objectives of acquisitions
2. To categorize the sample based on the objectives
3. To assess the impact of merger on performance of the acquiring firms

Hypothesis

H0: There is no significant difference in the performance of acquiring firms after merger

H1: There is a significant difference in the performance of acquiring firms after merger

IV. Population and Sample

The study has taken into consideration all the deals during the study period 2010-11 to 2014-15. The population of the study is 358 acquiring companies. The acquiring companies which are registered in a country other than India have been eliminated from the population. That company for which financial data is unavailable has also been eliminated from the list. The final sample taken for study is 106 firms after eliminating deals based on above criteria.

Data

Secondary data have been for this study. The details regarding the objectives for acquiring have been collected from SEBI database. The financial data required for performance analysis have been retrieved from prowess database.

Tools for analysis

The categorization has been done using percentage analysis. Financial performance is measured using profitability ratios. The ratios used for this purpose are Return on networth, Return on capital Employed, Return on Total Assets and Net profit margin. Further the profitability ratios are tested using paired sample t test.. The following table represents the deals taken for study during different years.

V. Data Analysis and Interpretation

Table 1: Number of deals during the study period

Year	No: of deals	Percentage
2010-2011	26	25
2011-2012	22	21
2012-2013	30	28
2013-2014	18	17
2014-2015	10	9
Total	**106**	**100**

The above table depicts the total data into year wise. It can be noted that the first three years has the highest number of deals of the study period. The year 2012-13 is having the highest number of deals. The deals in 2012-13 represent 28 % of total deals during the study period. It is followed by the year 2010-2011 with 26 deals. The least number of deals has happened in the 2014-15 which is only 10. The deals in 2012-13 represent 28 % of total deals during the study period.

The motives behind mergers and acquisitions has been identified for the sample deals of 106 and classified based on the objectives. This has been helped in identifying the motives behind mergers and acquisitions during the study period. The motives identified are consolidation, diversification, expansion, growth, strategic investment and synergy. The following table depicts the classification of the deals based on its motives.

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Table 2 Objective wise classification of deals

Sl. No	Objective	Number of firms	Percentage
1	Consolidation	20	19
2	Diversification	26	25
3	Expansion	23	22
4	Growth	12	11
7	Synergy	25	24
	Total	106	100

It can be noticed from the above table that the most important motives of mergers as considered by the companies is diversification. Diversification is supposed to bring in balance in the cash flow of the company. Hence risk can be avoided. Acquiring companies which are not in the same line of business of the acquirer helps them in eliminating the risk of incurring a complete loss. Consolidation is considered to be the next important objective of acquisition. Growth is the least important objective for acquisition.

The objectives of acquisitions have been further classified based on the industry type of the acquiring company. This analysis helps in understanding the different types of industry involved in the process of M & A during the study period.

Table 3: industry wise classification of objectives

Industry/Objective	Consolidation	Diversification	Expansion	Growth	Synergy	Total
Building & Construction	1	3	0	1	1	6
Chemical	3	4	7	2	1	17
Computer Software	5	7	5	1	4	22
Consultancy	0	4	6	1	3	14
Health Care	0	5	0	3	4	12
Other fee based financial services	6	2	3	3	2	16
Steel	5	1	2	1	10	19
Total	20	26	23	12	25	106

The sample of acquiring companies represents seven industries. It is found that the computer software industry has got the most number of acquisitions during the study period which is 22. It has been closely followed by the steel and chemical industries. The most number of acquisition deals in Computer software industry is for the objective of diversification. On the other hand the steel companies have selected acquisitions mostly for the attainment of synergy. The least number of acquisitions during the study period is in the building and construction industry and here again the main objective is diversification.

Table 3 : Pre and post merger ratios of Acquiring firms

	Pre-Merger (3 years before)	Post Merger (3 years after)	t-value
Return on Net Worth	15.550	14.670	0.305
Return on Capital Employed	10.400	9.060	0.117
Return on Total Assets	12.400	11.560	0.203
Net Profit Margin	8.020	7.940	0.950

The result of paired sample t test showed the above results. It was found that there is a difference in the profitability ratios of the companies that acquired during the study period. The statistical test result shows that the difference is not significant. It has also been found that the profitability ratios of the acquiring firms have reduced after the merger.

VI. FINDINGS AND SUGGESTIONS

Consolidation, expansion, diversification growth and synergy are identified as the objectives of acquisitions for the samples selected. Of which diversification and synergy are the most important objectives. Growth is the least important objectives of acquisitions. The industry analysis of the sample reveals that seven industries are involved in the process of acquisition during the study period. The industries identified are –Building and construction, chemical, computer software, consultancy, health care, other fee based financial services and steel. Computer software and steel industries have seen the most important acquisitions. The pre and post merger performance analysis of the acquired companies revealed that the mergers and acquisitions was not successful in improving the performance of the acquiring companies.

VII. CONCLUSION

It is concluded from the study that the acquisition activity has not brought any improvement in the profitability of the acquiring firms. It is in line with the other studies

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undertaken to test the premerger and post merger performance.

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