EFFECT OF MERGERS AND ACQUISITIONS ON FINANCIAL PERFORMANCE: A STUDY OF SELECT TATA GROUP COMPANIES IN INDIA

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ABSTRACT

Mergers and acquisitions becomes the major force in the changing environment. The policy of liberalization, decontrol and globalization of the economy has exposed the corporate sector to domestic and global competition. It is true that there is little scope for companies to learn from their past experience. Therefore, to determine the success of a merger, it is to be ascertained if there is financial gain from mergers. The main objective of the study is to evaluate the post-merger financial performance of the acquirer companies in India. The financial data has been collected for six years from 2004-10. Pre-merger and post-merger financial ratios have been examined using paired sample 't' test. The results of the analysis reveal that there is no significant difference between the financial performance of the companies before and after the merger. Further, it has been found that the type of company does seem to make a difference to the post-merger operating performance of acquiring firms.

Introduction

The mergers and acquisitions in India have changed dramatically after the liberalization of Indian economy. The policy of liberalization, decontrol and globalization of the economy has exposed the corporate sector to domestic and global competition. Low cost products, with good quality have become essential for a company to survive in the competitive market. Factors like low interest rates, cheap labour, and liberal government policy, have helped the Indian corporate sector to reduce their cost. It is in this context that corporate sectors view mergers for further cost reduction through technology advancement or to make their presence felt in the market. The liberalization policy of Government of India has witnessed an unprecedented number of mergers and acquisitions in the country. In terms of the growth rate in mergers and acquisitions deals, India occupies the second position in the world. In today's globalized economy, competitiveness and competitive advantage have become the buzzwords for corporate around the world. Corporate worldwide have been aggressively trying to build new competencies and capabilities, to remain competitive and to grow profitably. The world is in a state of flux, being influenced by the forces of globalization and fast technological changes and as a consequence firms are facing intense competition. To face the challenges and explore the opportunities, firms are going for inorganic growth through various strategic alternatives like mergers and acquisitions (M&A), strategic alliances, joint ventures etc. In early 1990s mergers, acquisitions, takeovers and other strategic alliances in the corporate sector geared up for a large scale restructuring in the face of cut throat competition from multinational corporations as well as exploiting new opportunities. The phenomenon recorded an upsurge in the wake of liberalization measures resulting into lessening the Government controls, regulations and restrictions. Mergers and acquisitions becomes the major force in the changing environment. The policy of liberalization, decontrol and globalization of the economy has exposed the corporate sector to domestic and global competition. It is true that there is little scope for companies to learn from their past experience. Therefore, to determine the success of a merger, it is to be ascertained if there is financial gain from mergers.

Review of Literature

The following are the few existing studies reviewed which were conducted by researchers in the view of analyzing the financial performance during merger activity in different time periods.

Mansur (2003) in his case study, "**Forecasting the Viability and Operational Efficiency by use of Ratio Analysis - A Case Study**", assessed the financial performance of a textile unit by using ratio analysis. The study found that the financial health was never in the healthy zone during the entire study period and ratio analysis highlighted that managerial incompetence accounted for most of the problems. It also suggested toning up efficiency and effectiveness of all facets of management and put the company on a profitable footing.

Pramod Mantravadi and Vidyadhar Reddy (2007) in their research study, "**Mergers and Operating Performance: Indian Experience**", attempted to study the impact of mergers on the operating performance of acquiring corporate in different periods in India, after the announcement of industrial reforms, by examining some pre- and post-merger financial ratios, with chosen sample firms, and all mergers involving public limited and traded companies of nation between 1991 and 2003. The study results suggested that there are minor variations in terms of impact on operating performance following mergers in different intervals of time in India. It also indicated that for mergers between the same groups of companies in India, there has been deterioration in performance and returns on investment.

The study entitled, "**Effect of Mergers on Corporate Performance in India**", written by Vardhana Pawaskar (2001), studied the impact of mergers on corporate performance. It compared the pre- and post- merger operating performance of the corporations involved in merger between 1992 and 1995 to identify their financial characteristics. The study identified the profile of the profits. The regression analysis.

Canagavally R.(2000); **"An Analysis of Mergers and Acquisitions"** they 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.

N. M. Leepsa & Chandra Sekhar Mishra (2009), **"Post Merger Financial Performance: A Study with Reference to Select Manufacturing Companies in India",** there intends to study the trend in merger and acquisition (M&A) particularly with reference to manufacturing companies. The present study is an attempt to find out the difference in post-merger performance compared with pre-merger in terms of profitability, liquidity and solvency. The statistical tools used are descriptive statistics, paired sample t-test.

To sum up the review of literature, many contributions have offered different perspectives of merger in different industries worldwide and explained the valuation techniques followed by merging companies, and shareholders wealth effect due to merger. From the review of many excellent research papers analyzing the pre and post merger performance of merged companies, it is inferred that majority of the studies strongly support the concept of enhanced post merger performance due to merger and it is beneficial to the acquirer companies.

Statement of the problem

Many studies have been conducted to analyze corporate events like mergers, takeovers, restructuring and corporate controls. The researchers have generally focused on public and corporate policy issues, financial implications and method of valuation. However, most of the studies have deeply concentrated only on the analysis of financial performance of both acquirer companies in the premerger period and specifically compared the performance of acquirer companies during pre and post merger period. There has been no comprehensive analysis attempted from the view point of the acquirer companies in the pre- and post- merger periods. Hence, in order to fill this gap in research, the present study attempts to analyze the liquidity performance of acquirer in the pre- and post-merger period.

Research objectives

1. To see the impact of merger and acquisitions on operating performance of firm in select Tata group companies.
2. To evaluate the pre and post merger of Profitability and Liquidity performance of the acquirer companies.
3. To give suggestions and recommendations to the companies under study, to improve the performance.

Research hypothesis

Ho: There is no significant difference between the financial performance of the companies before and after the merger.

Ha: There is a significant difference between the financial performance of the companies before and after the merger.

Methodology of the study:

Sample for the study

We have two selected Tata group companies in India which have acquired.

- Tata power acquired with Coastal Gujarat power in April 2007
- Tata steel acquired with Rawmet industries in march 2007

Period of the study

For the purpose of selecting sample companies, the present study covers a period of six years from 1st April, 2004 to 31st March, 2010. But order to evaluate the profitability and liquidity performance of sample companies on a comparative basis, three years before merger and three years after merger were considered.

Sources of data

The present study basically depends on secondary data. The required data on profitability liquidity performance before and after merger were collected for the six year period and they were obtained from annual report, www.moneycontrol.com. The data were also collected from books, articles in various journals, magazines and newspapers.

Tools used

In order to study the profitability and liquidity performance of acquirer companies, ratios Operating Profit Margin, Gross Profit Margin, Net Profit Margin, Current Ratio, Quick Ratio and Paired sample test were used.

Data presentation and analysis

Empirical tests were carried out on the collected financial data with the help of ratio analysis, mean, standard deviation and paired sample test. The pre-merger average performance of the acquirer companies were compared with the post merger performance of the combined firm. The present study attempts to measure and analyze the pre and post merger performance of acquirer companies by using profitability ratios namely, Operating Profit Margin, Gross Profit Margin, Net Profit Margin and liquidity ratios, namely, Current Ratio, Quick Ratio in order to ascertain whether mergers resulted in shareholders wealth or not. Accordingly, the following null hypothesis has been tested.

Table no.1 Analysis of Profitability ratios of Tata power and Tata steel company Ltd. during pre and post merger period

Ratios	Type	Mean	Std. Deviation	t	Sig.(2-tailed)	Null hypothesis
Tata Power Company						
Operating Profit Margin	Pre	23.9233	5.93015	.736	.539	**Accept**
	Post	19.0633	6.15476			
Gross Profit Margin	Pre	21.9567	4.03820	1.666	.238	**Accept**
	Post	13.6800	4.99087			
Net Profit Margin	Pre	12.7367	.93853	-.390	.734	**Accept**
	Post	13.1833	1.04844			
Tata Steel Company						
Operating Profit Margin	Pre	37.4833	4.48132	-.225	.843	**Accept**
	Post	38.4400	3.18867			
Gross Profit Margin	Pre	36.8767	4.57722	.604	.607	**Accept**
	Post	34.2500	3.20688			

Net Profit Margin	Pre	20.8333	4.21209			**Accept**
	Post	21.4933	1.76981	-.195	.863	

Source: Financial statements of companies Data compiled by SPSS version 20.

*__Accept__ denotes not statically significant relationship 5% level of significance.

*__Reject__ denotes statically significant relationship

In the present case, the acquisition of the Tata power company comparison between pre and post performance of Operating profit margin, Gross profit margin and Net profit margin you can see the decline the in the Mean of parameters that indicates that there is no change in the performance of the companies after merger and result shows there is no significance with Mean (23.9233% & 19.0633%) and t-value .736 and (21.9567% & 13.6800%) and t-value 1.666 and (12.7367% & 13.1833%) and t-value -.390.

In the Tata steel company comparison between pre and post performance of Operating profit margin, Gross profit margin and Net profit margin you can see the decline the in the Mean of parameters that indicates that there is no change in the performance of the companies after merger and result shows there is no significance with Mean (37.4833% & 38.4400%) and t-value -.225 and (36.8767% & 34.2500%) and t-value .604 and (20.8333% & 21.4933%) and t-value -.195. From the above analyses of Tata power and Tata steel company we conclude that all the Profitability ratios indicates that negative effect and decreased the performance of the companies after merger announcement.

Table no.2 Analysis of Liquidity ratios of Tata power and Tata steel company Ltd. during pre and post merger period

Ratios	Type	Mean	Std. Deviation	t	Sig.(2-tailed)	Null hypothesis

Tata Power Company						
Current Ratio	Pre	1.7800	.44542	6.186	.025	**Reject**
	Post	1.5300	.38691			
Quick Ratio	Pre	1.9367	.39879	.395	.731	**Accept**
	Post	1.8967	.23692			
Tata Steel Company						
Current Ratio	Pre	.6867	.02517	-1.331	.315	**Accept**
	Post	1.9467	1.61711			
Quick Ratio	Pre	.3400	.04583	-1.374	.303	**Accept**
	Post	1.6167	1.65107			

Source: Financial statements of companies Data compiled by SPSS version 20.

***Accept** denotes not statically significant relationship 5% level of significance.

***Reject** denotes statically significant relationship

In the present case, the acquisition of the Tata power company comparison between pre and post performance we seen that the mean value of Current ratio(1.7800% & 1.5300%) has decreased with t-value 6.186 which significant improvement in Current ratio after the merger but in Quick ratio you can see decreased in the Mean of the parameters that indicates there is no change in the performance of companies Quick ratio after merger and results shows that there is no significance with Mean (1.9367% & 1.8967%) and t-value .395.

In the Tata steel company comparison between pre and post performance of Current ratio and Quick ratio you can see the increased in the Mean of parameters that indicates that there is no change in the performance of the companies after merger and result shows there is no significance with Mean (.6867% & 1.9467%) and t-value -1.331 and (.3400% & 1.6167%) and t-value -1.374. From the above analyses of Tata power and Tata steel company we conclude that in Liquidity ratios some ratios indicates effect but most of the ratios shows the negative effect and decreased the performance of companies after merger announcement.

Justification of the study

In order to carry out the study, Tata power and Tata steel companies have been selected due to the following reason:

1. Both companies belong to one group.

2. Both the companies acquired other companies in the same year.

3. To know whether the expectation with which companies have been acquired have determined results or not.

Conclusions

Merger is useful tool for growth and expansion in corporate sector. This study was undertaken to test whether the company type has an impact on the outcome of merger for the merging firm, in terms of impact on operating performance. The results from the analysis of pre- and post-merger operating performance ratios for the acquiring firms in the sample showed that there was a differential impact of mergers, for different Corporate sectors in India. Type of company does seem to make a difference to the post-merger operating performance of acquiring firms. The results of this study shows that management can't take it for granted that synergy will be generated and profits will increase simply by going for mergers and acquisitions. The result and analysis of the key financial ratios of the acquiring firms shows that there is no significant effect on the profitability of the firms following acquisitions. The result and analysis of the key financial ratios of the acquiring firms shows that there is no significant effect on the profitability of the firms following acquisitions. This study examines the acquisition effect on the sample of Two companies.

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