



Synergy effect of cross border acquisitions: Evidence from India

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Abstract

In this paper a study is done to evaluate the pre-merger and post-merger of cross border acquisitions. In most cases mergers and acquisition is done to increase the performance of the companies, but studies have shown the opposite results. This paper tries to find out the how Cross border mergers and acquisition of perform pre and post its merger. The study is conducted on 20 Indian selected companies to evaluate its performance pre and post-merger. The analysis is done using paired sample t test to find out the performance pre and post-merger. The t test in this paper is calculated on the basis of four parameters. The four parameters are taken on the basis which affects the performance of the companies' pre and post-merger. The parameters taken in these projects are the return on capital employed, financial synergy, operating synergy and also the economies of scale.

Keywords: mergers and acquisition, ROCE, financial synergy, operating synergy, ROE, ROA

1. Introduction

The growth of mergers & acquisitions (M&A) is not a creation of recent times. The first M&A evolved at the end of the 19th century. Since then, changes are observed with different developments emerging due to radical different strategic motivations. The mergers and acquisitions in the past showed a pattern. The pattern is characterized as a wave and they occur in burst combined with relative inactivity. When we discuss these merger waves, economics usually refer to 6 specific waves starting from 1890. The length and start of each wave is not specific, but the end of each wave usually falls with a major war or the beginning of a recession/crisis. The first and second wave was only relevant for the US market, while the other waves had more geographical dispersion. Especially in wave five, where besides US, UK and continental Europe, Asia also had a significantly increased M&A market.

In the fast changing business world, companies have to try hard to achieve quality and excellence in their fields of operation. Every company's prime objective is to grow profitably. The profitable growth for the companies can be possible internally as well as externally. The internal growth can be achieved either through the process of introducing or developing new products or by expanding or by enlarging the capacity of existing products or sustained improvement in sales. External growth can be achieved by merger and acquisition of existing business firms. Mergers and Acquisitions (M&A) are quite important forms of external growth. In today's globalized economy, mergers and acquisitions are being increasingly used the world over as a strategy for achieving a larger asset base, for entering new markets, generating greater market shares/additional manufacturing capacities, and gaining complementary strengths and competencies, to become more competitive in

the marketplace. Mergers and Acquisitions (M&A) are an extensive worldwide phenomenon and Mergers and Acquisitions (M&A) have emerged as the natural process of business restructuring throughout the world.

1.1 Motives for Mergers and Acquisitions

Companies make mergers and acquisitions for a long list of reasons. Most of these reasons are to for the better performance of the companies and also to maximize shareholder value. Companies should pursue a merger or an acquisition only if it creates value—that is, if the value of the acquirer companies will lead to better performance than one single company. A merger or acquisition is justified if synergies are associated with the transaction. Synergies can take three forms: operating, financial, or managerial. Operating Synergies arise from the operations of the acquired firm and the target firm. A first type of operating synergies is revenue enhancement. It includes gaining pricing power in a particular market or being able to increase sales volume by accessing new markets. A second type of operating synergies is cost reduction.

Financial Synergies come from lower financing costs. Big companies usually have access to a wider and cheaper pool of funds than small companies. One rationale for the third wave of M&As was that diversifying into unrelated businesses enabled companies to reduce risk and, therefore, increase their debt capacity and lower their before tax cost of financing. The risk reduction benefit is compounded by the beneficial tax treatment of debt relative to equity.

Managerial Synergies arise when a high-performing management team replaces a poor-performing one. One advantage of acquisitions is that they give the acquirer the opportunity to remove incompetent managers, which could improve the target's performance.

2. Review of Literature

Mahesh Kumar Tambithis paper studies the performance of mergers and acquisition of Indian companies. The author studies the mergers and acquisition on the basis of four parameters to determine the growth of the companies in the Indian context. The four parameters are return on capital employed, financial synergy, operating synergy and economies of scale. The author has done t statistics in order to achieve the results by using paired sample statistics. The results showed that there were no positive results that the author found after doing the test.

Harbirsingh and Cynthia A. Montgomery (1987) investigated if the corporate acquisition returns in comparison with unrelated products are higher. The results of this research showed that the acquired firms in related acquisition have higher returns of that of unrelated acquisition of firms. The superior results of the related acquisition showed that combining of resources of related firms will have a higher value than combining two unrelated firms

Donald R Fazer and Hao Zhang (2009) study the market reaction to the acquisition done by combining two cross border banking firms. They examine operating performance of combined firm 3 years before and after the merger with the bank mergers. They measure the performance based on the operating cash flow return on assets (OPCFROA). The sample consisted of 83 mergers from the year 1980 – 2001 periods in which U.S banks acquired non U.S banks. This paper also showed further studies related to financial ratios on the post-acquisition in improvement in OPCFROA by evaluating changes in the bank performance ratios. The results suggested that the cash flow performance of foreign acquired of U.S banks were below performance. The foreign parents were able to improve the performance of the targets significantly in the 3 years after acquisition, in some cases to above the industry norm.

Sugandh Kansal, ArtiChandani (2013) has studied the changes that can happen in the process of mergers and acquisition between two companies. According to the authors merger is not only seen from the financial perspectives but it is the union of two different companies and two different cultures which is bound to bring some anomalies. This paper tells us the different types of M&A and also the various points to look while the transition takes place and also looks at the ways in which the employees get adjusted to changes in the organisation and also how the running of the organisation must be maintained smoothly.

Pradeep Kumar Gupta (2012) has focused mainly on the strategic concepts of mergers and acquisition of corporate sector. The author talks about the domestic and cross border M&A happened and the impact it has created in the market. This paper also talks about the different motives, strategies and synergies of mergers and acquisition. The Corporate Mergers and Acquisitions result in significant restructuring of the industries and can contribute to rapid growth of industries by generating Economies of Scale, increased competition in the market and raise the vulnerability of the stockholders as the value of stocks experience ups and downs after a merger or acquisition.

VassilisPapadakis (2007) the author in this paper tells us how different is mergers and acquisition from 1980's and the recent times. The author also talks about the usually made mistakes in M&A and also the reasons why one must have a detailed research on the acquiring company by looking at its overall aspects rather than just its financials. The author also tells how Sarbanes-Oxley world helped senior management and boards of directors have to abide by a new set of regulations and that makes them more careful in planning and implementing mergers. The recent research shows that 42 percent of the 50 largest deals taken place in 2005 are close to being considered as horizontal integrations.

3. Methodology

In this paper the testing of paired sample t test is done to determine the performance of the company by using four parameters that affect them. To get the pre-merger and post-merger paired sample test 2 years before merger and 2 years after merger values are taken. The four parameters taken are Return on Capital Employed, Operating Synergy, Financial synergy, Economies of scale

1. Return on Capital Employed: To test the overall performance of the acquirer company the return on capital employed is taken into consideration. The ROCE of the respective company and to determine the pre-merger value ROCE of two years before merger is taken and weighted average is calculated for each, on the weighted average of each year simple average for two years is calculate to get the value of pre-merger. Similarly the same is done for post-merger value also.

In the end we will have two values one pre-merger and one post-merger

2. Operating Synergy: To test the operating synergy of the companies the operating profit margin is taken as the criteria and weighted average for each year is taken and simple average on the weighted operating profit margin to get two different values.

3. Financial Synergy: To test the financial synergy I have taken the net profit margin and have calculated weighted average for each year like the above parameters in order to get two different values for pre-merger and post-merger.

4. Economies of Scale: To test the economies of scale the I have taken the net sales and average cost of production and divided them to find out the value for each year and later simple average is done to get pre and post-merger value.

5. Return on Equity: Return on Equity is the return got on net income as a percentage of shareholders equity. It helps us to understand how much profit an organisation makes with the shareholders money invested.

In this study I take Return on Equity ratio to understand company's profitability with the shareholders money. To study the pre and post-merger I have taken Return on Equity ratio from the financial ratios of the merged company.

6. Return on Asset: Return on Asset shows an organisation how profitable an organisation is relative to its total asset. It helps the organisation to understand how efficiently the organisation is using their asset to generate earnings for

the organisation. In this study I take Return on Asset ratio to understand company's how efficiently the organisation is using their asset to generate earnings for the organisation. To study the pre and post-merger I have taken Return on Asset ratio from the financial ratios of the merged company.

4. Empirical Results

1. For ROCE when I tested the t test I found out that the Mean of pre-merger was 9.8 and the mean of post-merger was 6.86 which we can see that the performance of the company has reduced post-merger has reduced compared to the pre-merger mean value and the paired sample t test was shown in the tests as 2.941 and the 95% level of confidence interval of the difference was between -0.418 to a upper value of 6.299.
2. For the test conducted on the operating synergy, where operating profit margin was taken into consideration test I found out that the Mean of pre-merger was 9.2590 and the mean of post-merger was 13.33565 which we can see that has increased in post-merger as compared to the pre-merger mean value and the paired sample t test was shown in the tests as -1.466 and the 95% level of confidence interval of the difference was between -9.897531 to a upper value of 1.744231
3. For the test conducted on the Financial synergy test, where net profit margin was taken into consideration I found out that the Mean of pre-merger was 9.09400 and the mean of post-merger was 2.1615 which we can see that has reduced in post-merger has reduced compared to the pre-merger mean value and the paired sample t test was shown in the tests as 1.718 and the 95% level of confidence interval of the difference was between -1.514485 to a upper value of 15.379485
4. For the test conducted on the Economies of scale test, where Average cost of production and net sales was taken into consideration I found out that the Mean of pre-merger was 7715 and the mean of post-merger was 71325 which we can see that has reduced in post-merger has reduced compared to the pre-merger mean value and the paired sample t test was shown in the tests as 0.967 and the 95% level of confidence interval of the difference was between -.067815 to a upper value of 184315.
5. When I ran the paired sample t-test I found out that the pre-merger mean was 18.939 and standard deviation was 17.839 and the post-merger mean was 17.1135 and standard deviation was 20.007. This shows the average mean that the companies have pre and post-merger and in this case it also increases post-merger. The paired sample correlation test table showed the correlation as 0.734. The paired sample test showed the mean difference of 0.5313 and also standard error mean of 1.825 and t test of 0.585.
6. When I ran the paired sample t-test I found out that the pre-merger mean was 10.985 and standard deviation was 11.738 and the post-merger mean was 13.0410 and standard deviation was 21.758. This shows the average mean that the companies have pre and post-merger and in this case it also increases post-merger. The paired sample

correlation test table showed the correlation as 0.662. The paired sample test showed the mean difference of -2.056 and also standard error mean of 3.6909 and t test of -0.556.

5. Conclusion

From the results conducted I was able to conclude that in most of the cases ie... Analysis done on the four parameters, I can say that the tests did not prove to have a positive impact on the performance of the company. In the analysis I found out that the ROCE, Financial Synergy, Economies of Scale did not increase post-merger which shows that the performance of the merged companies reduce rather than expected. In return on asset I found out that the t-test showed negative results showing us that the return on assets on companies was not effective. In return on equity the shareholders I found out that the mean of pre and post mergers has increased and can say that the shareholders return has been increased

The operating synergy is seen to be increasing post-merger which makes an impact on the performance of the companies. Looking at the operating synergy can conclude that all mergers and acquisition does not look at all factors for better performance, different companies have different motive that leads them to mergers and acquisition.

So to conclude on the basis of the study it can be said that the mergers do not contribute to the better performance of companies.

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