Chapter Six

SUMMARY OF FINDINGS, CONCLUSION AND SUGGESTIONS
Mergers and acquisitions have increased significantly in India in recent times. The inorganic growth option has occupied a significant place in strategy formulation process of Indian corporate sector. While mergers have occurred in India in 1970s and 1980s, the focus then was on revival of sick units, social good and managing the forces of strict regulations including licensing raj and permits. The focus of corporate restructuring through mergers and acquisitions has since then changed. Particularly, with implementation of economic reforms in 1991 and opening up of Indian economy, the Indian corporate firms have started looking at mergers and acquisitions from a very different perspective - that of being competitive, increasing market share, cost reduction and control, product portfolio diversification, supply chain management and exploiting core competence. The objective of mergers and acquisitions today is not only building a strong business empire and improving profitability, but passing on the benefits of mergers to shareholders in terms of increased wealth.

This research focussed on examining the ultimate objective of mergers and acquisitions, i.e. maximisation of shareholder wealth. With several companies adopting M&A as key strategy to strengthen their market position and paying substantial premiums on acquisitions, it becomes necessary to evaluate this strategy from the viewpoint of shareholder.

A number of established, recognized and published sources were used to collect the required data and analysis undertaken with well established
methodologies. This chapter summarises the major findings from this process of analysis and results and draws conclusions on the achievement of objective of creating shareholder wealth. We further provide suitable suggestion based on our findings and the direction for future research on the subject.

6.1 Summary of Findings

(A) Trends in Mergers and Acquisitions in India

(i) The pre-liberalization era severely restricted mergers and acquisitions in India by imposing regulatory restrictions through multiple legislations like FERA, MRTP and licensing system. In particular, there was lot of discouragement to horizontal combinations. The real impetus was given to mergers and acquisitions through the 1991 economic reforms that encouraged liberalization, privatization and globalization. Easing of regulations, sale of state-owned companies, overcapacity and deregulation of fragmented industries gave boost to M&A in India.

(ii) A total of 9,631 M&A transactions have occurred during the entire period from 1995-96 to 2006-07. The number of M&A deals has grown at CAGR (Compounded Annual Growth Rate) of 35.47% during study period.

(iii) Between 1995-96 and 1999-2000 the M&A have grown at CAGR of 63.62% while between 2000-01 and 2006-07 the CAGR is -2.16%. Thus, though the later period accounted for sizeable M&A deals on aggregate as well as year-on-year basis, in terms of growth rate,
the former period of 1995-96 to 1999-2000 has been more significant.

(iv) The year wise data on mergers and acquisitions separately clearly reveals that number of acquisitions have always been more than the number of mergers. On an average, every year, the number of acquisitions is more by 628 cases as compared to number of mergers and thus 3 times more than the number of mergers during the entire period from 2000-01 to 2006-07. The trend analysis within mergers indicate that the number of mergers are rising while on the other hand the trend analysis within acquisitions indicates that the number of acquisitions is falling on year on year basis.

(v) The intensity of cross-border M&As has increased significantly during the period from 1995 to 2006. The major countries of focus in cross-border mergers and acquisitions have been Europe and North America on account of larger consumer markets and healthy business climate. The major industries focussed in cross-border M&As during 1995 to 2000 have been consumer goods and services, pharmaceuticals and healthcare and energy which together accounted for 66% of cross-border M&A activity. Subsequently, IT and high technology industries have also gained significance.

(vi) The average value per acquisition deal has grown substantially from Rs.33.96 Cr. in 2001-02 to Rs.224.06 Cr. in 2006-07 representing a significant increase of 560% over six year period.
(vii) Sectoral analysis of mergers and acquisitions indicate that service sector has accounted for maximum number of mergers and acquisitions for the entire period from 1995-96 to 2006-07. Within that financial services has contributed significant number of mergers and acquisitions with 117 cases in first half of the study period from 1995-96 to 1999-2000 and 1074 cases in the remaining part of the study period. The other sectors that have been significant contributors to number of M&As in India during the study period are chemicals and drugs and pharmaceuticals sector and IT and Telecom sector.

(viii) Factors such as growth in consumer credit, geographical reach and branch penetration and growth in capital markets have boosted M&As in financial services sector. Synergy motivation and cost control has been the focus of consolidations in chemicals sector. Improving marketing network and dealing with R&D issues have encourage M&As in Indian pharmaceuticals sector, while building competitiveness has been the driving force behind M&As in textile and food and beverage sectors in India.

(B) Effect of M&A Announcement on Share Prices of Acquirers

(i) The average Cumulative Abnormal Returns for acquirers in Manufacturing Sector have been positive during the study period. The average CAR values are found to be statistically significant at period (t-5) i.e. during 5 days before the announcement of merger
event, 20 Days around announcement and 10 days around announcement of merger.

(ii) The announcement period returns of acquirers in Manufacturing Sector are highest during pre-announcement period and fall sharply during the post announcement period.

(iii) The highest magnitude of announcement period cumulative abnormal returns of acquirers in Manufacturing Sector (7.11%) accrue during 40 days around the announcement date i.e. (t-20, t+20) event window. However, these returns are not statistically significant.

(iv) Interestingly, shorter the period taken around announcement of merger, lesser is the cumulative abnormal returns for the shareholder indicating lowering of investor expectation from merger as the information on possible merger benefits is processed by the market participants.

(v) More than 60% of observations of CAR of acquirers in Manufacturing Sector are positive during pre-announcement period. However, during post announcement period the percentage of positive CARs dropped to 53.70%.

(vi) Sectoral analysis of announcement period returns indicate that Average CARs are substantially lower during pre-announcement period for acquirers in Chemical Sector while the same increases during post-announcement period. Average CAR for acquirers in Chemical Sector are -6.14% during (t-20) window but 5.14% during...
(t+20) window. However, average CAR for period of 10 days after announcement (7.86%) only is found to be statistically significant for acquirers in chemical sector. For Textile Sector, the average CARs are positive and higher for period from (t-20) to (t+5) after which it drops significantly. For pharmaceuticals Sector, the average CAR is highest (4.50%) for (t-20) window, though it falls sharply during other event windows of pre-announcement period as well as post announcement period with lowest average CAR being -0.81% for (t+20) window. Again here, it is observed that the average CARs are lower during the period that is closer to the announcement date of mergers and acquisitions. However, none of the returns are statistically significant. The shareholders of acquirer firms in Food and Beverage Sector see a substantial drop in CAR during post announcement period from statistically significant 21.09% for (t-20) window to statistically insignificant 2.98% for (t+20) window. Average CARs have higher magnitude for longer period around merger announcement date in this sector [20.76% for (t-20,t+20) window]. On the other hand for much closer event window (t-5, t+5) the average CAR is 1.98%.

(vii) In case of acquirers in Financial Services Sector, it is observed that average CAR is -7.41% for (t-10) window. However, it improves substantially for event windows closer to announcement date and particularly for (t+20) post announcement period, the average CAR is 9.13% which is also statistically significant at 10% level.
(C) **Long Term Operating and Financial Performance of Acquirers**

(i) Aggregate analysis of Manufacturing Sector reveals that all the profitability ratios of acquirers have declined. Although decline is not statistically significant it indicates that M&A have not contributed in improving their profitability. The mean net profit margin of acquirers, however, has seen very marginal decrease (0.33%) in post-merger period (from 5.78% to 5.45%). The decline is however, statistically insignificant.

(ii) The mean fixed asset turnover ratio of acquirers in Manufacturing Sector has declined from 3.27 times to 2.32 times and the decline is found to be statistically significant at 10% level.

(iii) The operating return on assets though has marginally increased from 0.19% to 0.20%, this increase is found to be statistically insignificant.

(iv) The mean short term solvency parameter measured by way of Current Ratio has declined marginally for acquirers in Manufacturing Sector and though this decline is statistically insignificant, the Pearson paired sample correlation coefficient (0.71) is significant at 1% for the current ratio indicating consistency in fall in current ratio across the sample size during post-merger period.

(v) Sectoral analysis reveal that for Chemical Sector, the mean return on capital employed and mean return on networth have shown statistically insignificant decline of average of 2.20% and 2.43%
respectively. The decline is however found to be consistent across the sample acquirer firms in chemical industry. Increase in cost of production and falling rate of growth of profits after tax have contributed to this decline.

(vi) Textile Sector has shown worst post-merger performance with decline in ROCE (mean decline of 2.46%) and RONW (mean decline of 5.91%) during post merger period being statistically significant. The average rate of growth of Profit After Tax (PAT) of acquirers in this sector has declined by 98.24% during post merger period as also the growth rate of sales.

(vii) All the profitability ratios of acquirers in Food and Beverage Sector except net profit margin have shown decline during the post-merger period. The operating return on assets has also declined for this sector. Further, the average rate of growth of PAT of acquirers in this sector has declined by 408.94% though cash flow position has registered an impressive growth.

(viii) Relatively Drugs and Pharmaceutical Sector has shown better performance with increased net profit margin and return on networth as well as operational efficiency post-merger. Short term solvency as measured by current ratio has however declined (mean decline of 0.61) during post merger period and is found to be statistically significant at 10% level.

(ix) With reference to Financial Services Sector, the acquirers in banking business have seen a very marginal increase in
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profitability ratios (mean increase of Net Profit to Total Funds of 0.12% and mean increase of RONW 0.91%). Acquirers in other Financial Services business have seen visible gains in profitability ratios (mean increase of 26.25% in Profit After Tax and mean increase of 4.71% in RONW post merger). However, in both cases the mean difference in various ratios for pre and post merger period is found to be statistically insignificant.

(x) With respect to long term buy and hold abnormal returns, only textile sector is found to have earned statistically significant mean returns of 61.42% and 66.01% during 1 year and 2 year holding period. None of the other sectors reported statistically significant mean returns.

6.2 Conclusion

6.2.1 Trends in Mergers and Acquisitions in India

(i) Regulatory changes and economic reforms have been major reasons for bringing significant changes in M&A scene in India.

(ii) Acquisitions have become more popular than the mergers in Indian context due to facilitation from SEBI Takeover code, 1997, and also due to convenience in handling such transaction in comparison to mergers that create more post-integration challenges for acquirers. However, the cost of acquisitions is also on the rise and this higher cost of acquisition is probably one
reason why growth rate of acquisition has come down during the study period.

(iii) With service sector contributing more than 57% of Indian economy, majority of M&As in India during study period have been in service sector. Within that the financial services sector has seen a significant rise in M&As and the trend is likely to continue in future.

(iv) The major reasons for increasing consolidations in India are the industry specific advantages, cost reduction, exploiting core competence and global competition. These factors have skewed the M&A activity in India towards horizontal and vertical mergers and acquisitions. The diversified M&A have been thus reduced to negligible number.

(v) The rise in cross-border M&A activity is indicative growing competence of Indian business entities and their desire to build big businesses by capturing global markets.

6.2.2 Effect of M&A Announcement on Share Prices of Acquirers

(i) Except for financial services sector, all the other sectors have mostly reported positive cumulative abnormal returns to shareholders of acquirer companies, though the trend in this positive average CAR is that of decline. Besides, most of the observations of average CAR across various sectors did not show statistical significance. At the same time, except for drugs and pharmaceuticals sector, all the other sectors have at least one and
maximum of three observations of average CAR as statistically significant. Thus, it can be concluded that there is a weak evidence of short term announcement period gains to shareholders of acquirer companies in various sectors, other than drugs and pharmaceuticals sector.

(ii) The pattern of movements in average cumulative abnormal returns is similar for manufacturing sector on overall basis, textile sector, drugs and pharmaceuticals sector and food and beverage sector. The investors have shown negative expectations from mergers in these sectors as indicated by declining trend in average CAR as the announcement date neared. On the other hand for chemicals sectors and financial services sectors, the pattern of movement in average cumulative abnormal returns is same with negative pre-announcement effect getting nullified as the announcement date nears and subsequently turning positive. This indicates of positive expectations of investors from merger process for these sectors.

(iii) Overall, the shareholders have benefitted by trading in shares of acquirer companies in manufacturing sector during event window much closer to announcement date while those in financial services sector have benefited only during 20 days post merger announcement period.
6.2.3 Long Term Operating and Financial Performance of Acquirers

(i) The analysis of financial ratios to gauge implications of mergers and acquisitions on operating performance of acquirers reveals that M&A activity has not been able to provide much needed synergic benefits to the acquirers. Most of the positive ratios have registered a decline in real terms while in other cases, the negative ratios such as debt-equity ratio has increased during post merger period. Even if the decline reported is not statistically significant in several cases, the absence of strong evidence of improvement in profitability or solvency or efficiency ratios indicates that the mergers and acquisitions have failed to bring about improvement in long term operating performance. In other words, there is no value addition done to the acquirer firms so as to increase the wealth of shareholders in future.

(ii) With reference to sectoral analysis of operating performance post merger it can be concluded that drugs and pharmaceuticals sector has relatively performed better in comparison to other sectors under study. On the other hand textile sector has been worst performer on fundamental parameters. The cash flow position has improved in post merger period for the acquirers across various sectors, but this has not translated into recognizable gains in profitability and efficiency of operations.

(iii) Within financial services sector, the non-banking acquirers have seen relatively better real performance in comparison to banking
acquirers though the absence of statistical significance to this improvement renders it weak evidence of improved performance.

(iv) Year on year analysis of financial ratios of acquirers across different sectors provide evidence of statistically significant decline in profitability/efficiency/solvency ratios but does not provide similar evidence on increase in performance parameters.

(v) With reference to long term buy and hold returns it can be concluded that no significant positive returns have accrued to shareholders of acquirers in various sectors during Post announcement period. Shareholders of Acquirers firms in textile sector are found to earn significant positive buy and hold abnormal returns for upto 2 years holding period. The significant positive long term returns when the sector has performed the worst in terms of operating performance is indicative of market inefficiency and excessive expectations by investor on probable benefits of mergers in this sector.

6.3 Suggestions

Literature on mergers and acquisitions globally has time again established the fact that M&A activity does not contribute significantly to shareholder wealth creation. The general conclusion of this research is that mergers and acquisitions in India are nothing different from those of the rest of the world in terms of their implications on shareholders wealth. The findings of this study are useful to the prospective acquirers, corporate strategists and investors in
general. With reference to the conclusions drawn from this study we provide the following suggestions:

(i) Since mergers and acquisitions have not found to be contributing significantly to profitability, liquidity and solvency or operational efficiency, the acquirers need to assess whether paying substantial purchase considerations for these transactions is economically viable for the firm in the long run. Given the fact that acquisitions premiums are rising, it becomes imperative for acquirers to evaluate the inorganic growth strategy against the organic growth options available.

(ii) The acquirers need to identify appropriate target that has complimentary fit within the acquirers own organizational structure, product portfolio and work culture. Post merger integration issues may be one significant reason for failure of M&As to improve long term operating and financial performance of acquirer companies. As Machi (2005) suggests, organization structure with similar management problems, cultural system and structure will facilitate the effectiveness of communication pattern and improve the company's capabilities to transfer knowledge and skills.

(iii) Acquirers need to find out if they are overpaying for their acquisitions as it is one of the most important reasons for failure of mergers and acquisitions in creating shareholder value (Abyankar, Ho and Zhao, 2005). It is suggested that the valuations for a target firms be carefully decided based on rational judgements and not because the acquirer can afford paying extra premiums.
(iv) Very few observations of long term buy and hold returns from merger are found to be statistically significant and that too for the worst performing sector. Investors need to study the fundamentals of acquirer firm before investing in its shares for long term. The mismatch between market valuation and fair valuation of firm once discovered can result in substantial losses to investors thereby eroding their wealth from holdings in acquirer firm.

6.4 Scope for Further Research

(i) The study can be extended to more sectors based on availability of data in future.

(ii) Future research on the topic can also be directed to include cross border mergers and acquisitions which are increasingly becoming significant in Indian economy. A detailed sectoral analysis of these mergers and acquisitions can be made to identify if there are any concrete gains to acquirers. This is particularly important given that cross border M&As involve a very large purchase consideration.

(iii) An analysis of contribution of various sectoral factors on operating and financial performance of acquirers during post merger period may be undertaken to provide deeper insight into determinants of post merger performance.

(iv) There is an urgent need to develop suitable methodology to separate the effects of multiple mergers on operating and financial performance of acquirers. This can enable a selection of larger
sample in M&A studies and thus significantly improve reliability of such studies.