CHAPTER 5

SUMMARY

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CONCLUSION
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5.1. SUMMARY

Corporate finance has always been a subject of enigmatic nature. It has drawn scores of researchers around the globe, where lots of studies have been conducted, conclusions have been derived but no final say has been done on any of the results! One small topic that is grabbing the attention of researchers since last more than 30 years and may go on for further many more years is the mergers and amalgamations. The topic has been of great interest because when the pilot study was done, it was observed that though finally the mergers results into reduction in profitability, why are they so popular? Lot of research has been done on mergers and amalgamations but cash flow as the tool for analysis has been rarely used. In the Indian market the study has more relevance because the Indian companies' phenomenon of mergers or acquisitions has been the recent ones.

To enable the researcher to learn from previous theory on the subject and to illustrate how the subject has been studied previously, a literature review was done. It provided the context for the research and also helped to refine, or refocus on the topic. It ensured that the work on mergers and amalgamations would be adding the understanding and knowledge of that field and justifies the research.

After reviewing the literature in depth, the following statements were agreed by most of the researchers till the current research was done.
There are two research approaches generally employed in addressing the question of impact of mergers and acquisitions on shareholders. One approach is to employ share price data to establish the distribution of gains and losses to shareholders. The other approach is to focus on the profitability of companies involved, using accounting data.

The empirical evidence has been conflicting as to what type of diversification strategy can in fact create value for the acquiring firm's shareholders.

Diversification theory has not yet been empirically confirmed. Assertions that mergers and acquisitions are a useful and productive method for diversification and growth, and those synergies are more readily and easily captured in related acquisitions; do not withstand the empirical test.

It is very difficult but still mergers are often viewed as a more favourable strategy than building the business internally giving rise to the merger & acquisition synergy paradox.

Security price studies are mostly based on event study methodologies that have focused on announcement period returns with an identification of the wealth gains or losses to the various groups of shareholders.

A few studies have been undertaken to study the long-run impact of M&As on the shareholders. Findings of most of the studies undertaken to study the impact of M&A activity on shareholders wealth for both short-run and long-run have revealed that M&As fail to create value or wealth for the shareholders of acquiring companies.

Firms located within industry clusters make more acquisitions, and have lower debt ratios and larger cash balances than their industry peers located outside clusters.

Indian companies are no different than the companies in other part of the world and mergers were failed to contribute positively in the performance improvement.
In India, merging companies which were taken over by companies with reputed and good management, it was seen that it was possible for the merged firms to turn around successfully in due course.

Through the study of the long-run performance of acquirers after acquisitions, some studies found that acquiring firms experienced significantly negative abnormal returns over the one to three year period after the acquisition.

Related acquisitions showed a higher profitability than unrelated diversification. It was also found that mergers between well-governed acquirers and poorly governed targets are profitable. It was also found that post-merger performance is negatively associated with relative target size and positively associated with long-term incentive compensation plans.

The event study methodology employed to assess the extent of value creation by mergers, indicates that on an average mergers lead to value destruction, irrespective of their pattern over a long period of time and the destruction is relatively greater in case of unrelated mergers.

Recent studies reveal 50% to 70% of all M&A activity fails to deliver the value intended. Typically, a merger loses 16% to 49% of combined market share within three to five years. Only 33% of companies recover the direct costs of the deal, some 35% of takeover targets are later divested.

Using a variety of financial measures (e.g. Profit, Stock price) and non-financial Measures (e.g. firm’s reputation) and time frame (e.g. pre-measurement and post measurement, initial market reaction etc.), these studies show that on average, M&As consistently benefits the target’s shareholders, but not the acquirer’s shareholders. In fact, there are varying results with respect to the buying firm’s performance.
So, looking at the conclusions of earlier researches the first and foremost the topic of mergers in context with cash flow analysis was selected. The required parameters for cash flow analysis could be easily located from the balance sheet in the published annual reports of listed companies. Then for verifying if this topic could meet the parameters of research or otherwise, a pilot study was conducted on a few companies even to check if this research is possible on large scale or not. After getting a positive feedback about the pilot study and experts’ advice on the same, the research process was started with the research methodology. All the merged companies listed on Bombay Stock Exchange were selected. The time span selected for analysis of pre-merger companies was 1997 to 2007 and for analysis of post merger companies it was from 1997 to 2009. The data was purely secondary in nature. To prove the topic, three hypotheses were formulated that were based on the indications of mergers received from cash flow analysis, the contradiction of stated motives of mergers and the post merger performance of merging companies. To prove these hypotheses, appropriate research tools were selected namely, Co-efficient of Correlation, Regression Analysis, ANOVA, F Test and simple average method. Analysis was done mainly on two tiers i.e. Pre-merger and Post-merger. The data was further analysed as a whole and top 20 and bottom 20 companies to check if the generalisations applies to small group or not.

Finally, all the three hypotheses were proved.
5.2 CONCLUSIONS RELATED TO THE HYPOTHESES

1. The Cash-Flow Analysis of the merged companies for their pre-merger period gives concrete evidences and/or indications of their probable mergers or acquisitions.

We have seen from the correlation and the regression analysis of the cash flow parameters that these parameters of cash flow give the concrete evidences or indications of the probable mergers of the companies. The analysis of variances (ANOVA) also supports the same hypothesis. In the Table 4.8.1.1, since F value is less than F critical, our hypothesis No. 1 is proved. Thus it is proved for pre-merger analysis of all companies taken together.

Similarly, in the analysis of top 20 companies prior to merger (Table 4.8.2.1) and bottom 20 companies prior to merger (Table 4.8.3.1), the hypothesis is proved.

It is also observed that as explained in 4.9 above, the simple averages calculated on all the parameters of cash flow analysis individually proves that one can get the indications of probable merger of the companies. Thus the hypothesis is proved with this method also.

2. The Cash-Flow Analysis of the merged companies before and after the merger or acquisition suggests contrary to the stated motives of merger or acquisition.

Usually, we have assumed certain motives of mergers which are stated in the theories of various corporate finance experts like the expansion, economies of scale, synergies of human resources, etc. But when we do the actual analysis of cash flow parameters, we have observed the contrary results like

a. The companies show good operating profits, but still they chose to get merged whereas when the business is doing well, they can continue as a separate entity.
b. The companies do not have good liquidity but just before mergers, they sell their capital assets and try to improve their liquidity conditions so that they are over-valued.

c. Prior to the merger decisions, the cash flow to equity shareholders and creditors increases abnormally in most of the cases. This may be because the company do not want to create panic among shareholders nor do they wish to face any resistance from the shareholders or the creditors of the company.

Because of such observations, we can say that the theoretically stated motives of mergers and actual motives of mergers are contradictory.

3. In most of the cases, merger or acquisition leads towards value destruction of the acquirer company.

We have seen from the analysis of cash flow parameters, that the post merger financial performance of the companies is not very satisfactory. They show the reduction in net working capital, lesser operating cash flow, less dividend/no dividend to equity shareholders, huge amount of loans raised from outside to pay off the creditors or dividend of shareholders, etc. All these symptoms are certainly not of a good financial position of the companies, so we can very well say that our hypothesis No. 3 is also proved. The correlation between cash flow parameters for all companies post merger (Table 4.6.2.1) explains the same. This analysis done for all the companies together also confirms for Top 20 (Table 4.6.2.2) and bottom 20 (Table 4.6.2.3) companies post merger.
5.3 CONCLUSIONS RELATED TO THE CASH FLOW PARAMETERS

We studied following five parameters of cash flow:-

- Change in Operating Cash Flow

It is observed that prior to merger; there is an abnormal increase in the operating cash flow without substantial reasons for such sudden rise. But this increase is not due to increase in business activity. It is also observed that that whenever, an operating cash flow is less, a free cash inflow is seen. This could be either through sister concerns or any loans. A sudden increase in OCF may also be attributed to liquidation of assets to improve the cash position. (Refer 4.8.1)

- Change in Capital Spending

It is also noticed that the capital spending of the companies is negative during the year of merger and a year proceeding to merger. This indicates that the companies are cutting down on their investment related expenses. This also indicates that the company may be planning to go for merger. (Refer 4.8.2)

- Change in Net Working Capital

It is also observed that the companies are cutting down their net working capital. Naturally, it indicates that the companies wants to cut down their business activity or wants to merge its business. This ultimately indicates that either the company is going for merger or is on the verge of getting acquired. (Refer 4.8.3)

- Free cash flow

It is observed that there is very high inflow of cash. This could be because the companies are raising some loan or it is taking it from its’ sister concern. This inflow is required to take care of the outflow such as payment to creditors’ or payment to shareholders, etc. But it should also be noted that the rise in free cash flow is not due
to increased operations of the companies. As we have seen in the analysis of OCF, Capital spending and Net Working Capital, none of the parameters indicates that the financial position of the companies is so good to have so high free cash flow. (Refer 4.8.4)

- Cash flow to Shareholders

It is observed that most of the companies declare highest dividends a year prior to merger or in the year of merger. The dividends are paid out either from the available cash or from some loan or transfers from sister concern if the fund position is not sufficient to pay off such dividends. It indicates that the company wants to keep the shareholders happy and satisfied so that the market value of the share is maintained. (Refer 4.8.5)

- Cash flow to Creditors

It is observed in most of the cases that the companies outflow to creditors increases a year prior to merger. Whatever cash is available with the company, the same is utilized for paying off its creditors. This also indicates that the company wants to wind up its operations. (Refer 4.8.6)

- Unexplained Cash Flow

This unexplained cash flow is calculated as the balancing figure between the cash inflow and cash outflow. As per the cash flow statement rules, the inflow and outflow must match but here we came across a vast difference between the two figures which we have quoted as unexplained cash flow. It is seen that the companies’ unexplained cash flow increases in very high proportion during the year of merger and a year prior to merger. This may be to take care of the increased demand of cash for paying off the creditors and payment of dividends to shareholders. (Refer 4.8.7)
These findings specifically pinpoint to hypothesis no.1 that is the analysis of cash flow parameters gives concrete evidences of the probable merger of the companies. So all these parameters put together does indicate the probable mergers. Out of all these parameters, Free Cash Flow is a better indicator to guess the probable merging company. We can very specifically say that Cash flow analysis is a powerful technique to identify the companies prone to merger. Out of the parameters chosen for this analysis, free cash flow is the best indicator.
5.4 GENERAL CONCLUSIONS

The regression analysis, which was done with operating cash flow and free cash flow with all the chosen parameters of cash flow analysis, the findings were:-

a. Operating cash flow and Capital Spending for the pre-merger period are not dependent on each other whereas in practice, when the operating cash flow is higher, it is assumed that the business and financial position of the company is good. Naturally, the capital spending should also be higher when the operating cash flow is high. But here the analysis is contradicting the practice. There could be manifold reasons behind this contradiction but we can very well say that it is indicating towards the probable merger of the company. (Refer 4.2.1.1)

b. The operating cash flow and the net working capital are not at all dependent on each other. This is again a contrast situation because in practice, the operating cash flow depicts sound financial position of the business. Naturally, when the business is doing well, the net working capital should also be proportionately higher but here it is not seen so. (Refer 4.2.1.2)

c. The operating cash flow and cash flow to equity shareholders do not depend on each other. When the company is showing good performance, it will declare good dividend to shareholders or vice versa but here, though the operating cash flow is higher, the dividend to shareholders are not depending upon the same which again contradicts the theory. (Refer 4.2.1.3)
d. The operating cash flow and cash flow to creditors to certain extent depends on each other. Here, the observations go hand in hand with the theory and the practice. (Refer 4.2.1.4)

e. The operating cash flow and free cash flow shows very insignificant relationship between them. Whereas, when the operating cash flow is going up, the free cash flow must also show similar increase. But here, it is showing very negligible correlation between the two parameters. This observation points out to the fact that there is some leakage of funds. It means the cash is flowing out of the companies to certain unstated modes may be to sister concerns but we cannot say so authentically as we have not analysed the cash flow of sister concern but this is one of the possibilities of why the insignificant relationship is seen between the two parameters. (Refer 4.2.1.5)

f. To certain extent, the operating cash flow and the unexplained cash flow are dependent on each other. Now this unexplained cash flow itself is a concept which arose due to some unknown inflow and outflow of cash. We have assumed that the inflow of unexplained cash is a transfer of funds from sister concern to the companies and outflow of unexplained cash is a transfer of funds to the sister concern of the companies but further research is needed to authenticate this statement. (Refer 4.2.1.6)

4. In case of analysis of all the parameters related to free cash flow for pre-merger period, it was observed that

a. The free cash flow and capital spending are directly dependent on each other means when free cash flow is higher the capital spending also increases which
exactly as per the theory and practice adopted in corporate finance. (Refer 4.2.2.1)

b. The free cash flow and net working capital also depends on each other positively. Here, higher the free cash flow, higher will be the net working capital which also proves as per the theory. (Refer 4.2.2.2)

c. The free cash flow and cash flow to equity shareholders in the form of dividend are not dependent on each other. Usually, when the company has more free cash flow, it will see that how the owners of the company i.e. the shareholders gets benefitted out of the same but here it is contradicting to the theory and the practice. (Refer 4.2.2.3)

d. The free cash flow and cash flow to creditors are not at all dependent on each other. Whereas, when the free cash flow is significant, the creditors should be paid off but here, this parameter is contradicting the theory. (Refer 4.2.2.4)

e. The free cash flow and unexplained cash flow depends on each other to a large extent. Here, as we stated above, it is seen that when the company has good free cash flow, it is either diverting the funds away or accepting the funds into the company from some unknown sources. Sometimes, the outflow is seen after paying off the creditors and dividend to shareholders but sometimes when the free cash flow is meagre or insufficient, it is seen that an inflow of cash is there in the form of unexplained cash flow. In theory, there is no such concept as unexplained cash flow because the inflow and outflow of cash must match with each other. (Refer 4.2.2.5)
5. In case of observations of operating cash flow for the post merger period, it was seen that

a. The operating cash flow of the companies and the capital spending are largely dependent on each other. It means during the post-merger period, the parameters of operating cash flow and capital spending do show a relationship which is just as mentioned in the corporate finance theory. This is exactly the opposite situation of pre-merger analysis. (Refer 4.2.3.1)

b. The operating cash flow and net working capital are dependent on each to certain extent. This again goes parallel with the theory. (Refer 4.2.3.2)

c. The operating cash flow and cash flow to equity shareholders shows higher dependency on each other. When the companies operating cash flow is higher naturally the cash flow to shareholders in the form of dividend will increase. These findings match with the stated theory. (Refer 4.2.3.3)

d. The operating cash flow and the cash flow to creditors are not dependent on each other. But this observation period contradicts the theory because when the operating cash flow is available then naturally the cash flow should be higher to creditors. When it is not, we can question the financial position of the company. (Refer 4.2.3.4)

e. The operating cash flow and free cash flow are very less dependent on each other which mean any increase in OCF will not necessarily show a similar increase in FCF. This is again contradicting the theory. (Refer 4.2.3.5)

f. The operating cash flow and the unexplained cash flow are observed to be less dependent on each other. (Refer 4.2.3.6)
6. In case of post merger analysis related to free cash flow it is seen that

a. The free cash flow and capital spending are highly dependent on each other. That is when the free cash flow is higher the capital spending is also higher in post-merger cases. This observation goes hand in hand with the corporate finance theory. (Refer 4.2.4.1)

b. The free cash flow and net working capital are less dependent on each other which means though the free cash flow increases, the net working capital do not show a similar increase or otherwise. (Refer 4.2.4.2)

c. The free cash flow and cash flow to shareholders is less dependent on each other. Unlike the pre-merger analysis where the FCF and Cash flow to shareholders do not show any effect on each other, during the post merger analysis, it is showing the dependency to certain extent. (Refer 4.2.4.3)

d. The free cash flow and cash flow to creditors is not much dependent on each other. Unlike the pre-merger analysis where the FCF and Cash flow to creditors does not show any effect on each other, during the post merger analysis, it is showing the dependency to certain extent. (Refer 4.2.4.4)

e. The free cash flow and unexplained cash flow shows very high dependency on each other. Here, it is seen that when the company has good free cash flow, it is either diverting the funds away or accepting the funds into the company from some unknown sources. Sometimes, the outflow is seen after paying off the creditors and dividend to shareholders but sometimes when the free cash flow is meagre or insufficient, it is seen that an inflow of cash is there in the form of unexplained cash flow. In theory, there is no such concept as unexplained cash
flow because the inflow and outflow of cash must match with each other. (Refer 4.2.4.5)

7. In case of summary statistics of pre-merger companies, where we analysed the mean, median, kurtosis, skewness of the data, the hypothesis no. 1 is proved for all the companies. It is also confirmed for the analysis of top 20 companies but regarding the bottom 20 companies, the findings are contradicting. (Refer 4.4.1 to 4.4.3)

8. In case of summary statistics of post-merger companies, the hypothesis no. 3 is proved that value destruction takes place of the acquirer company post merger. This is proved for the analysis of all the companies with top 20 and bottom 20 companies. (Refer 4.5.1 to 4.5.3)

9. The findings of correlation analysis also states that our hypotheses gets proved regarding the indications of probable merger from cash flow analysis and

10. The correlation analysis findings also confirm that the post-merger performance of the companies diminishes.

Even after all these findings, we see mergers and acquisitions as a regular trend in the corporate world. This gives rise to a question that even after proven value diminishing results of the mergers, why do the mergers happen? The only answer to this could be the mergers do happen for the motives which are other than those stated in the theory.
5.5 CONCLUSIONS RELATED TO THE OBJECTIVES

5.5.1. Objectives of the Study

a. To evaluate cash flow statements of merged companies on the basis of a few parameters like operating cash flow, capital spending, changes in working capital, etc. which can be indicative of financial position of the company before merger.

b. To check for any similarity in the findings of cash flow statements that could be pinpointing to the probable merger of the said company.

c. To check whether cash flow statement is a better tool for analyzing the pre-merger financial position of the companies as compared to conventional ratio analysis.

d. To analyse whether any hidden motives other than the stated motives of mergers can be traced out through cash flow analysis.

e. To assess whether the merger and acquisition really leads to value enhancement or value destruction of the acquiring company.

On the basis of these objectives, the following hypotheses were formulated:-

1. The Cash-Flow Analysis of the merged companies for their pre-merger period gives concrete evidences and / or indications of their probable mergers or acquisitions.

2. The Cash-Flow Analysis of the merged companies before and after the merger or acquisition suggests contrary to the stated motives of merger or acquisition.
3. In most of the cases, merger or acquisition leads towards value destruction of the acquirer company.

5.5.2 Conclusions Related To the Objectives

Objective (a)
The cash flow parameters were evaluated and it was observed that all the selected parameters do indicate the financial position of the companies. It was further observed that these parameters not only shows the financials of the companies but also gives the evidences of the probable merger of the companies. The abnormal increase or sudden decrease in certain parameters shows that the company is not functioning smoothly and there are probabilities of it getting merged or acquired.

Objective (b)
The analysis of cash flow parameters gives concrete evidences of the probable merger of the companies. So all these parameters put together does indicate the probable mergers. Out of all these parameters, Free Cash Flow is a better indicator to guess the probable merging company.

Objective (c)
Ratio analysis is very popularly used in many earlier researches. We came across hardly a few research papers using cash flow analysis as a tool. The intention behind using cash flow analysis was to develop an equally powerful tool for indicating the probable merger.

Objective (d)
The Analysis of Variance states that the stated motives of mergers like expansion, efficiency, empire-building, monopoly, etc. are not at all achieved but there are certain motives which are hidden. A further study in this regard is required to be undertaken.
Objective (e)

The post merger financial performance of the companies is not very satisfactory. They show the reduction in net working capital, lesser operating cash flow, less dividend/no dividend to equity shareholders, huge amount of loans raised from outside to pay off the creditors or dividend of shareholders, etc. All these symptoms are certainly not of a good financial position of the companies, so we can very well say that the mergers leads to value destruction of the acquiring company. The literature survey also supports the same.
5.6 LIMITATIONS OF THIS RESEARCH

❖ The study is concentrating on only those components from Cash flow Statement which could be indicative towards the probable merger or acquisition. That is, only those parameters are selected from which the cash flow position can be very well judged and used to analyse the probability of merger or acquisition of the company. Other indicators are not considered for this study.

❖ The study is limited to only those companies which are listed on Bombay Stock exchange. It may not be generalised for other stock exchanges within India or out of India.

❖ The analysis of the companies is completely based on only cash flow indicators not taking cognizance of external environment, market conditions, or any other factors motivating mergers, etc. which may have an impact on the data collected.

❖ The study is done on the data from 1997 to 2007 for pre-merger companies and 1997 to 2009 for the post-merger companies. The impact of time related aspects are not considered in the study.
5.7 SCOPE FOR FURTHER RESEARCH

❖ Over the years, there are certain pre-accepted motives behind mergers and/or acquisitions. These stated motives are well recognised not only by the finance experts but also by the common public, investors, stakeholders, etc. But while doing the analysis based on the cash flow tool, and as mentioned in the conclusions, these traditionally believed to be true motives are many times the illusionary motives. It is observed that the mergers take place for the motives other than the stated or theoretically accepted motives. To find these other motives, for which this restructuring activity is so popularly used in the world of corporate finance, is the area for further research.

❖ We have used cash flow analysis as a major tool of analysis. A researcher may use any other financial tool and observe the conclusions drawn by that tool. During the review of literature, it was observed by the researcher that ratio analysis is very commonly used tool in case of mergers and acquisition study. One can use some other financial tool and further find out the similarity or diversity in the observations using this different tool. We cannot put any remarks about the superiority or inferiority of any tool in corporate finance but we can compare the results and cross check the authenticity of conclusions. This is also an area for further research.

❖ We have analysed the data of 11 years for pre-merger companies and 13 years for post-merger companies. This is a very lengthy time span for any country’s economy to change itself thoroughly. For countries like India, which are growing by leaps and bounds, many external factors affect any of the movements in the world of corporate finance. Moreover, for standing tall in the global world, India is passing through many developmental phases especially during this particular time span of study. We have not considered any external factors, or economic activities or various economic
conditions into account while doing this study. Taking into consideration such external aspects may also be considered as an area of further research.

- Taking into account such economic activities and conditions in the corporate world, along with the cash flow analysis tool and finding convergence or synergy between the two which may lead to development of any new model for studying the indications of mergers or the post merger analysis may also be an area of further research.