ABSTRACT

Introduction

Corporate finance is the study of how investment and financing or restructuring decisions should be made in theory and how they are made in practice. With the advent of economic policy liberalization, deregulation and privatization M&A has become a buzzword in the corporate and non-corporate sectors in the developing countries. India is relatively late entrant to the arena of market reforms. The significant market reforms can be traced since 1990 in India. Mergers and acquisitions have been widely popular as a source of capital restructuring. The reason why mergers are so seductive is because it's the White Knight theory. Everyone hopes that if we merge with those other guys, they will be energetic enough and I'll be able to cruise. But unfortunately, the other guy is thinking the same way”.

A number of studies are carried out to analyze the cause effect relationships of mergers, the pre-merger and post merger analysis of the acquiring company, the wealth maximization of shareholders, post acquisition performance of acquirers, merger pricing, unimpressive economic outcome of most mergers etc.

There were lots of deliberations upon this topic before we conducted a pilot study on few companies. The pilot study revealed that mergers and acquisitions can be better speculated if some of the factors of cash flow analysis are studied.

After doing the complete analysis, it was found that the selected parameters of cash flow analysis do give the concrete evidences or indications that the company is going for a merger. Another fact that is consistent with the past studies that the mergers and acquisitions lead to value destruction of the acquiring company. It was also found that the stated motives and achieved motives of mergers also differ from each other. Clearly, it is not possible to ensure that no decision will ever turn out to be inappropriate, but it should be possible to minimize risk and maximize the chances of success, barring totally unforeseen circumstances.

Objectives of Research

The main objective of the study is the analysis of merger and acquisition phenomenon in the light of cash flow analysis. With this main aim, the journey of this research project was embarked upon to achieve the following objectives:

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.

**Research Methodology**

After doing a pilot study and literature review, we found out the various parameters of cash flow analysis that would be used to prove this research topic. Extra care was taken in seeing that the parameters and related variables of cash flow analysis would be accessible or not while collecting the data. So the nature of data to be collected was based on operating cash flow, capital spending, net working capital, cash flow to shareholders and cash flow to creditors. The variables considered for OCF were PAT and Depreciation, for capital spending the change in net fixed assets and depreciation were taken into account. Similarly, for change in net working capital, Inventories, Receivables, loans and advances and expenses paid in advance were considered. For arriving at cash flow to creditors, the calculations of financial service expenses, borrowings and amortisation were done. For calculations of cash flow to shareholders, the paid up equity capital and paid or proposed dividend were considered. Based on these calculations the free cash flow was calculated.

The analysis was divided into two parts for achieving better accuracy i.e. the pre-merger analysis and the post-merger analysis. The following items of the financial reports of all the companies for the stipulated time has been selected. The following variables were considered for the total analysis:- Income, Financial Service Expenses, Depreciation, Amortisation, Write Offs, Profit After Tax, Dividend Paid/Proposed, Paid up Equity Capital, Deposits, Borrowings, Current Liabilities & Provisions, Net Fixed Assets, Loans/ Advances, Inventories, Investments, Receivables, Expenses paid in advance, Cash & bank balance.

The data analysis for pre-merger period has been done on 969 companies using Simple Regression, t-test, correlation, Annova to establish a relation between each dependent and independent variable.
Data Source

The research methodology is completely based on the secondary data. The data has been obtained from Prowess of C.M.I.E. (i.e. Centre for Monitoring Indian Economy) which is the online corporate database. Only B.S.E.(i.e. Bombay Stock Exchange listed industries have been selected. Data was collected for 969 pre merger and 136 post merger companies. The analysis was done for 11 years prior to merger from 1997 to 2007 and 13 years post merger from 1997 to 2009. To test check the validity of the data, 25 companies' annual reports have also been cross verified.

Sampling

All the Bombay Stock Exchange (BSE) listed companies of CMIE – Prowess database which have undergone the mergers during 1997 to 2007 has been selected. This was the sampling frame and sample size. Out of 3 categories of industries i.e. Non-financial, Financial and Miscellaneous industries, miscellaneous industries have been omitted as it has Government sector companies and their capital restructuring norms are different than other companies as it is determined by fixed standards. After collecting the data, 18 items were selected to be used in the analysis. For pre merger analysis the companies we have considered 100% sample size because we wanted to establish a general relation between the cash flow analysis and indications of merger. Since we did not wanted to concentrate on any particular industry or group of companies, we selected whole sampling frame of 969 companies as our sample size.

For post merger analysis the information was initially collected for 150 companies but all the companies sufficient data was not available. So the data of 136 companies was finally analysed. For post merger analysis, the convenience sampling was done. The top 20 and bottom 20 companies were selected on the basis of FCF in the descending order.

Hypotheses

The following hypotheses have been set in relation to the topic:

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.
Scope of the Study

- The study and analysis of data is done only from the published audited annual reports.
- The study will be limited to only those companies which are listed on Bombay Stock exchange.
- The companies shall be chosen across a spectrum of various industries.
- A number of the merged companies from a particular sector will be compared with a number of unmerged companies from various sectors selected randomly.
- The analysis of the companies is completely internal not taking cognizance of external environment, market conditions, etc. which have an impact on the data collected.
- The study will focus on Cash flow statement as a tool of analysis.
- The cash flow statements will be analyzed for the pre-merger and post-merger period.
- The study will be based on secondary data provided by CMIE related to Mergers and Amalgamations.
- All the companies for the pre-merger analysis will be studied for a period of 10 years only.
- All the companies for the post-merger analysis will be studied for a period of 12 years only.

Data Analysis Tools

The data analysis has been done on 969 pre-merger and 136 post-merger companies using Simple Regression, t-test, Correlation, ANOVA, and Simple Average which have been applied to check if the results of the sample are consistent and valid even with 5% of error. The summary statistics was also used to confirm the validity of data.

Findings

- The correlation and the regression analysis of the cash flow parameters show 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. 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.
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. We can say that the theoretically stated motives of mergers and actual motives of mergers are contradictory. Our analysis of variance also states that the hypothesis no. 2 is proved.

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.

Conclusion

Mergers & acquisitions have been widely accepted tool of capital restructuring in corporate finance. Their popularity is well known. The merger literature has mostly concentrated on stock returns surrounding announcement dates, mode of acquisition and performance of acquiring firms. All the theories of mergers can be summarized into three categories. First category is the category of Synergy; it says that total value from the combination is greater than the sum of the values of individual firms. The second category says that total value from the merger is zero. This happens because of the mistake of the bidder to overpay for merger. Third category of merger theories says that total value from merger is negative. The empirical researches done in India and the studies done by various researchers across the globe, have time and again evaluated this phenomenon but still it remains very attractive for further research. In case of most of the mergers the shareholders are the last authorities to know on it. Though they are supposed to be the first ones to know about it as it is ultimately their money at stake, many times it becomes only a formality to put it up in the meetings and get it approved.

The present study concentrates on cash flow analysis and the parameters selected from cash flow analysis which may indicate the probable merger of the companies. It is concluded that prior to merger; there is an abnormal increase in the operating cash flow without substantial reasons for such sudden rise. It is also noticed that the capital spending of the companies is negative which shows that the companies do not want to invest in capital assets as they are planning to wind up the operations or getting ready for merger. It is also observed that the companies are cutting down their net working capital as they are no more interested in increasing their business operations but they
want a picture to be created wherein their liquidity will be much better than their actual liquidity. It is observed in most of the cases that the companies outflow to creditors increases a year prior to merger. This again points out to the fact that the companies wants to pay off their creditors at the earliest. It is observed that most of the companies declare highest dividends a year prior to merger or in the year of merger. This is done with the basic intention of keeping shareholders under the impression that everything is going on well in the company. This also supports to stabilize the market value of the shares as the company’s valuation largely depends on the market value of its shares.

It is also observed that whatever are the stated motives behind mergers, hardly any of the motives are successfully pursued over a long period of time. From the analysis of data, it is also seen that in most of the cases, merger or acquisition leads towards value destruction of the acquirer company. The literature review also supports the same observation. But still the fact remains that mergers and acquisitions are the most popular restructuring tools in corporate finance. We can also conclude that cash flow analysis is the most powerful tool to analyse the companies prone to merger.

Scope for Further Research

- It is observed that the mergers take place for the motives other than the stated motives. To find these other motives, is the area for further research.
- We have used cash flow analysis as a major tool of analysis, use of any other financial tool and observing the conclusions drawn by that tool and similarity or diversified observations is also an area for further research.
- Taking into account other economic activities and different economic conditions along with the cash flow analysis tool and finding convergence or synergy between the two which may lead to development of any new model may also be an area of further research.