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S. B. PATIL INSTITUTE OF MANAGEMENT

Seventh National Conference

On

**“MANAGING RESOURCE THROUGH
CREATIVITY FOR GENERATING
OPPORTUNITIES IN 21ST CENTURY”**

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'Managing Resource Through Creativity for Generating Opportunities in 21st Century'**

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EFFECT OF MERGERS AND ACQUISITIONS ON PROFITABILITY AND OPERATING PERFORMANCE OF FERTILIZER INDUSTRY IN INDIA

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ABSTRACT

One of the significant objectives of any corporate sector is to achieve high rate of economic growth. The main objective of the study is to evaluate the post-merger profitability and operating performance of the acquirer companies in India in Fertilize industry. The merger cases for the year 2003-04 to 2005 - 06 have been taken for the analysis. The financial data has been collected for six years. Pre-merger and post-merger ratios have been examined using paired sample t test. The results of the analysis reveal that there is no significant difference between the profitability and operating performance of the companies in fertilizer industry before and after the merger. The results of this study show that management can't take it for granted that synergy will be generated and profits will increase simply by going for mergers and acquisitions.

Keywords: *Mergers and Acquisitions, Profitability performance, Operating performance, Fertilizer Industry.*

Introduction:

The general rule of corporate synergy signifies that the value created by the combination of firms may result in more efficient management, economies of scale, improved production techniques, a combination of complimentary resources, the redeployment of profitable uses, and the exploitation of market power or any number of values creating mechanisms. Mergers and Acquisitions (M&A's) are the dominant corporate strategies followed by organizations looking for enhanced value creation. The growing tendency towards M&A's world-wide, has been driven by intensifying competition.

The term "merger" is not defined under the Companies Act, 1956, the Income Tax Act, 1961 or any other Indian law. Simply put, a merger is a combination of two or more distinct entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but to achieve several other benefits such as, economies of scale, acquisition of cutting edge technologies, obtaining access into sectors / markets with established players etc. Generally, in a merger, the merging entities would cease to be in existence and would merge into a single surviving entity.

The terms mergers and acquisitions are generally used interchangeably, but often differ by situation. Merger normally refers to unification of two equal players into one entity. Acquisition refers to one player buying out another to combine the bought entity with itself.

In Indian industry, the pace for mergers and acquisitions activity picked up in response to various economic reforms introduced by the Government of India since 1991, in its move towards liberalization and globalization. Over the last decade, mergers and acquisitions in the Indian industry have continuously increased in terms of number of deals and deal value. However, financial gain will emerge in the post-merger period when the two companies are worth more together than apart. Therefore, there is a need to study the post-merger financial performance which can be helpful in assessing the success of merger.

REVIEW OF LITERATURE:

An extensive review of literature has been carried out in order to enhance the level of understanding in the area of mergers, gain insight into the impact of mergers on the financial performance of acquirer companies and formulate research problem for further.

Gallet C.A (1996), "Merger and Market Power in the US Steel industry" He examine the relationship between mergers in the U.S. steel industry and the market power. The study employed New Empirical Industrial Organization (NEIO) approach which estimates the degree of market power from a system of demand and supply equations. The study analyzed yearly observations over the period between 1950 and 1988 and results have revealed that in the period of 1968 to 1971 merges did not have a significant effect on market power in the steel industry; whereas mergers in 1978 and 1983 did slightly boost market power in the steel industry.

AnupAgraval Jeffrey F. Jaffe (1999), "The Post-merger Performance Puzzle" they examines the literature on long-run abnormal returns following mergers. The paper also examines explanations for any findings of underperformance following mergers. We conclude that the evidence does not support the conjecture that underperformance is specifically due to a slow adjustment to merger news. We convincingly reject the EPS myopia hypothesis, i.e. the hypothesis that the market initially overvalues acquirers if the acquisition increases EPS, ultimately leading to long-run under-performance.

Saple V. (2000), "Diversification, Mergers and their Effect on Firm Performance: A Study of the Indian Corporate Sector" he finds that the target firms were better than industry averages while the acquiring firm had lower than industry average profitability. Overall, acquirers were high growth firms which had improved the performance over the years prior to the merger and had a higher liquidity.

Beena P.L (2000), 'An analysis of merger in the private corporate sector in India', she attempts to analyze the significance of merger and their characteristics. The paper establishes that acceleration of the merger movement in the early 1990s was accompanied by the dominance of merger between firms belonging to the same business group of houses with similar product line.

Vardhana Pawaskar (2001), "Effect of Mergers on Corporate Performance in India" he studied the impact of mergers on corporate performance. It compared the pre- and postmerger 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 explained that there was no increase in the post- merger profits. The study of a sample of firms, restructured through mergers, showed that the merging firms were at the lower end in terms of growth, tax and liquidity of the industry. The merged firms performed better than industry in terms of profitability.

Paul (2003) "The merger of Bank of Madura with ICICI Bank". The researcher evaluated the valuation of the swap ratio, the announcement of the swap ratio, share price fluctuations of the banks before the merger decision announcement and the impact of the merger decision on the share prices. He also attempted the suitability of the merger between the 57 year old Bank of Madura with its traditional focus on mass banking strategies based on social objectives, and ICICI Bank, a six year old 'new age' organisation, which had been emphasizing parameters like profitability in the interests of shareholders. It was concluded that synergies generated by the merger would include increased financial capability, branch network, customer base, rural reach, and better technology. However, managing human resources and rural branches may be a challenge given the differing work cultures in the two organizations.

Joydeep Biswas (2004) "Recent trend of merger in the Indian private corporate sector". They research about Corporate restructuring in the form M&A has become a natural and perhaps a desirable phenomenon in the current economic environment. In the tune with the worldwide trend, M&A have become an important conduit for FDI inflows in India in recent years. In this paper it is argued that the Greenfield FDI and cross-border M&A's are not alternatives in developing countries like India.

Vanitha. S (2007) "Mergers and Acquisition in Manufacturing Industry" she analyzed the financial performance of the merged companies, share price reaction to the announcement of merger and acquisition and the impact of financial variables on the share price of merged companies. The author found that the merged company reacted positively to the merger announcement and also, few financial variables only influenced the share price of the merged companies.

Vanitha.S and Selvam. M (2007) "Financial Performance of Indian Manufacturing Companies during Pre and Post Merger" they analyzed the pre and post-merger performance of Indian manufacturing sector during 2000-2002 by using a sample of 17 companies out of 58 (thirty percent of the total population). For financial performance analysis, they used ratio analysis, mean, standard deviation and 't' test. They found that the overall financial performance of merged companies in respect of 13 variables were not significantly different from the expectations.

Kumar (2009), "Post-Merger Corporate Performance: an Indian Perspective" examined the post-merger operating performance of a sample of 30 acquiring companies involved in merger activities during the period 1999-2002 in India. The study attempts to identify synergies, if any, resulting from mergers. The study uses accounting data to examine merger related gains to the acquiring firms. It was found that the post-merger profitability, assets turnover and solvency of the acquiring companies, on average, show no improvement when compared with pre- merger values.

To sum up the review of literature, many contributions have offered different perspectives of merger in different industries worldwide. There has been no comprehensive analysis attempted from the view point of the acquirer companies in the pre- and post- merger periods for fertilizer industry in India. The present paper attempts to fill this gap in research.

RESEARCH METHODOLOGY:

Acquiring companies listed on BSE in Fertilizer Industry in India of the time period from the year 2003 – 04 to 2005 – 06 have been considered for the study. The financial data has been collected for six years. Three years before Merger and Acquisition and Three years after the Merger and Acquisition, the year of acquisition is not considered for the study. The pre-merger and post-merger averages for a set of key financial ratios have been computed for 3 years prior to, and 3 years after the year of merger completion. Financial data for the study has been collected from respective company’s annual reports. The analyzing profitability performance Operating Profit Margin, Gross Profit Margin and Net Profit Margin are calculated. For analyzing operating performance Return on Net Worth, Return on Capital Employed and Debt Equity Ratio are considered. To study the pre and post effect ‘t’ test is used. The data has been analyzed by using SPSS.

RESEARCH OBJECTIVES

1. To evaluate the post-merger profitability performance of the Fertilizer industry India.
2. To evaluate the post-merger operating performance of the Fertilizer industry India.

RESEARCH HYPOTHESIS

1. There is no significant difference between the profitability performance of the fertilizer industry before and after the merger.
2. There is no significant difference between the operating performance of the fertilizer industry before and after the merger.

RESULT AND DISCUSSION

1. Profitability Performance

Ratios	Pre-merger (3 years before)	Post-merger (3 years after)	t - (0.05 significance)	Remark
Operating Profit Margin	0.238	0.195	0.010	Significant
Gross Profit Margin	0.173	0.13	0.069	Not Significant
Net Profit Margin	0.068	0.086	0.391	Not Significant

The above table shows pre and post-merger profitability performance of Fertilizer industry through Operating Profit Margin, Gross Profit Margin and Net Profit Margin. The operating profit margin in post-merger duration has been declined and the decline is statistically significant. The decline in Gross Profit Margin has been observed but this decline is not statistically significant. In the case of Net profit Margin it shows improvement, this improvement though not significant statistically. The results suggest that profitability performance had not improved.

Based on the above results of the analysis, the null hypotheses in case of Operating Profit Margin is Rejected whereas the null hypotheses is Accepted for Gross Profit Margin and Net Profit Margin.

Operating Performance

Ratios	Pre-merger (3 years before)	Post-merger (3 years after)	t - (0.05 significance)	Remark
Return on Net Worth	0.37	0.328	0.541	Not Significant
Return on Capital Employed	0.143	0.19	0.446	Not Significant
Debt - Equity Ratio	3.925	2.785	0.195	Not Significant

The above table shows pre and post-merger operating performance of Fertilizer industry through Return on Net Worth, Return on Capital Employed and Debt-Equity Ratio. The Return on Net Worth had declined whereas the decline is not statistically significant. The Return on Capital employed has improved to an extent but then the same is not statistically significant too. Debt – Equity Ratio suggest to reduction in debt as compared to equity however this also is statistically not significant.

On the basis of result analysis, the null hypotheses that there is no significant difference between the operating performance of the fertilizer industry before and after the merger is Accepted.

CONCLUSION:

This study was undertaken to test whether the fertilizer industry had impact of mergers and acquisitions in terms of profitability performance and operating performance. The results from the analysis pre-merger and post-merger profitability performance have been declined and in case of operating performance ratios have not indicated improvement. These results shows that management of companies in fertilizer industry can't take it for granted that synergy will be generated and profits will simply increase by going for mergers and acquisitions.

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