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Post Acquisition Performance of Indian Telecom Companies: An Empirical Study

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Abstract

Mergers and Acquisitions (M&A) are the most popular means of corporate restructuring or business combinations and are a big part of today's corporate finance world. They are considered as one of the strategies for improved financial performance and growth. The companies are expected to perform much better post M&A so that the overall wealth of the shareholders can increase. From the review of literature it is found that there is no convincing evidence of the impact of M&A on corporate performance. This study is an effort to find out the difference between pre and post- acquisition performance of five acquirer telecom firms involved in M&A (2000-2010) in terms of profitability, liquidity and solvency. Accounting ratios and paired sample t-Test are used to analyze the performance of the companies.

Keywords: Mergers, financial performance, telecom firms, profitability, liquidity, solvency

Introduction

According to Straub (2007), the phrase Merger & Acquisition refers to the aspect of corporate strategy, corporate finance, and management dealing with the buying, selling, and the combination of another company that can aid, finance, or help a growing company in a given industry to grow rapidly without having to create another business entity, that is, when a company decides to acquire a target company, it is making an investment. The general principle is that the acquiring company should go ahead with the acquisition if by doing so it creates a net contribution to shareholders wealth. In a merger, there is a complete amalgamation of assets and liabilities as well as shareholders interests and businesses of the merging companies.

It is believed that mergers and acquisitions are strategic decisions leading to the maximization of company's growth by enhancing its production and marketing operations. They have become popular in the recent times because of enhanced competition, breaking of trade barriers, free flow of capital across countries and globalization of business as a number of economies are being deregulated and integrated with other economies.

Currently, a slew of mergers and acquisitions in telecom sector are going on throughout the world. The aim behind such mergers is to attain competitive benefits in telecommunication industry. India has become the world's second-largest telecom market and has third largest internet users in the world. Also, its total subscriber base has reached to 1.05 billion (TRAI, 2018). Mergers and acquisitions in the telecommunication sector have been showing a prosperous trend in the recent past and the economists are advocating that they will continue to do so. In the majority of the developed and developing countries around the world, mergers and acquisitions in the telecommunication sector have become a necessity. So, both transnational and domestic telecommunication services providers are keen to try merger and acquisition options because this will help them in many ways, that is, they can cut down on their expenses, achieve greater market share and accomplish market control.

Literature Review

Review of Literature has been made on the impact of M&A on the company's operating and financial performance. Most of the research work done in India is restricted to banking, finance and M&A across various sectors as a whole. No much comprehensive research has been done on M&A in Telecom in India. Literature review has not been able to derive a convincing evidence whether M&A leads to value creation for shareholders or not.

Pawaskar (2001) studied the impact of mergers on corporate performance and compared the pre and post merger operating performance of corporations involved in mergers and identified the financial characteristics of the corporations. He also studied the effect of mergers on merger induced monopoly profits by studying the persistence of profile of profits. Bansal et al. (2008) also analyzed the impact of merger and acquisition on corporate performance and assessed whether the claims made by the corporate sector while going for merger and acquisition to generate synergy were achieved or not. They studied a large number of merger and acquisition cases and showed that in many cases the acquiring firms were able to generate synergy in long run in the form of higher cash flow, more business, diversification and cost cutting etc. They also suggested that the management should not take it for granted that synergy will be generated simply by going for merger and acquisitions. Sinha et al. (2010) also in their research article examined the impact of mergers and acquisitions on the selected financial institutions in India. They studied the impact of the changes in the efficiencies of the company during the pre and post merger period by using non parametric wilcoxon signed rank test. The result of the study indicated that merger and acquisition cases in India showed significant correlation between financial performance and merger and acquisition deals especially in long run. They concluded that the acquiring firms were able to generate value. Pithadia et al. (2010) studied the impact of mergers and acquisitions on the financial performance of Indian corporate sectors. They examined and evaluated the impact of merger and acquisitions on return on investment, profitability and liquidity position of selected companies. The study concluded that from the point of view financial evaluation the merging companies were taken over by companies with reputed and good management and that the post acquisition performance of the acquirer firms did not prove to be beneficial for them. Gupta et al. (2011) in their paper examined the mergers & acquisitions scenario of the Indian financial services sector. The data for eighty cases of mergers and acquisition in the period from 1993- 2010 was collected for a set of ten financial parameters representing the various characteristics of a firm. They analyzed all the cases individually and collectively to determine the overall effect of merger and acquisition in the industry. The results of the study indicated that PAT and PBDITA had been positively affected after the merger but the liquidity condition represented by current ratio had deteriorated. Whereas cost efficiency and interest coverage improved and deteriorated in equal number of cases. Interest Coverage remained an important factor in determining the return on shareholder's funds both before and after the merger but Profit Margin was also important after the merger. They concluded that the diversification effects of merger, in two out of the three cases were such that there had been a reduction in total and systematic risk. Prasad et al. (2012) studied the performance of the Indian airline companies after the consolidation of airline sector and analyzed whether the Indian airline companies have achieved financial performance efficiency during the post merger and acquisition period in the areas of profitability, leverage, liquidity and capital market standards. The differences in financial performance standards two years before and two years after the merger activity of both target and surviving company from the period 2005-2008 were analyzed. The study revealed that there was no improvement in surviving company's return on equity, net profit margin, interest coverage, earning per share and dividend per share post merger and acquisition.

Research Objective

To analyze and compare the financial performance of the telecom acquirer companies pre and post merger.

Research Methodology

Scope of the study

In the current study five merger and acquisition cases are studied to evaluate and compare the financial performance of the acquirer firms from the pre and post merger perspective. The performance has been evaluated taking into consideration two years pre and post merger data of the acquirer company. The cases include:

1. Merger of Idea Cellular with Spice Telecom
2. Vodafone Acquisition of Hutch

3. Merger of NTT DoCoMo with Tata Teleservices
4. Merger of Bharti Airtel and Zain Africa
5. Merger of Telenor and Unitech Wireless

The study covers the time period from 2000-2010

Data Analysis

To study the impact of merger and acquisition on financial performance of the company's in the Indian Telecom Sector, data of five years has been taken into consideration which includes two years data from pre merger and acquisition period and two years data from post merger and acquisition period and also year in which merger and acquisition took place.

For analyzing secondary data i.e. financial data from Balance Sheets, Profit and Loss Accounts and Cash Flow Statements of the five companies (two years pre and post merger) have been used to calculate and analyze the accounting ratios which are also known as performance indicators. The accounting based studies seek to determine whether mergers and acquisitions are followed by changes in profitability or not.

Table 1: Variables of the study

Parameters	Variables	Explanation
Liquidity Ratio	Current ratio(CR)	Current Assets / Current Liabilities and provisions
	Quick Ratio(QR)	Current Assets-Inventories/ Current Liabilities and provisions
Profitability Ratios	Earnings Per Share(EPS)	Net Income-Preferred dividends/Weighted Average Common Shares Outstanding
	Net Profit Ratio(NP)	Profit after tax/ Net Sales
	Return on Capital Employed(ROCE)	Earnings before interest and taxes/Capital employed
	Return on Net Worth(RONW)	Profit after tax/ Net worth
Solvency Ratios	Debt Equity Ratio	Total Debt/Equity
	Interest Coverage Ratio	Earnings Before Interest and Taxes/Total Interest

Hypothesis

For the purpose of the current study the following Hypothesis was set

H0- There is no significant difference in the mean score of selected companies, Liquidity, Solvency and Profitability ratios respectively.

Hypothesis Testing

Average pre and post-acquisition financial performance ratios are compared to see if there is any statistically significant change in financial performance due to mergers and acquisitions using paired sample t-Test.

Analysis

Evaluation of the Liquidity, Profitability and Solvency position of the Selected Companies

Table 2: Average Liquidity Ratios of the Selected Companies before and after merger

Name of company	Current Ratio		Quick Ratio		Difference	
	Pre Merger X1	Post Merger Y1	Pre Merger X2	Post Merger Y2	D1=Y1-X1	D2=Y2-X2
Idea cellular	0.81	1.08	0.55	0.50	0.27	-0.05
Vodafone	0.57	0.47	0.56	0.34	-0.1	-0.22
Tata Teleservices	0.41	0.39	0.33	0.17	-0.02	-0.16
Bharti Airtel	0.58	0.53	0.25	0.39	-0.05	0.14
Telenor	0.72	0.73	0.68	0.71	0.01	0.03
					$\sum$D1=0.11	$\sum$D2= -0.26

Source: Data compiled from annual reports of the Selected Companies

Table 2 indicates the Average Current ratio and Quick ratio of the selected companies 2 years before and after the merger. In the pre merger period, Idea Cellular showed the highest Average Current ratio of 0.81 followed by Telenor 0.72, while Tata Teleservices and Vodafone's Current ratio stood at 0.41 and 0.57 respectively. In the post merger period the Average Current ratio of Idea Cellular increased to 1.08 while there was a nominal increase in case of Telenor at 0.73. On the other hand, remaining 3 companies showed a decline in the Average Current ratio. Similarly, in the pre merger, Telenor showed a highest Average Quick ratio of 0.68 followed by Vodafone at 0.56. For the remaining three companies including Idea Cellular, Tata Teleservices and Bharti Airtel, the Quick ratio amounted to 0.55, 0.33 and 0.25 respectively. In the post merger period, the Average Quick ratio of only Telenor improved and there was a decline in the Average Quick ratio of the remaining 4 companies. The total average difference between the pre and post merger Current ratio and Quick ratio for all the selected companies figured at 0.11 and -0.26 respectively. This indicates that on an average, the liquidity position of the selected companies did not improve after merger and acquisition.

Table 3: t- Test Analysis of the Selected Companie s- Liquidity ratios

Test Statistics	Current ratio		Quick Ratio	
	Pre-merger	Post-merger	Pre-merger	Post- merger
N	5	5	5	5
Mean	0.618	0.64	0.474	0.422
Variance	0.02357	0.0763	0.03163	0.04007
P	0.881402		0.675589	
A	0.05		0.05	
Result	H_0		H_0	

At the given level of significance $\alpha = 0.05$, $P > \alpha$, there is no evidence that the mean scores for the companies differ, hence we fail to reject the null hypothesis.

Table 4: Average Solvency Ratios of the Selected Companies before and after merger

Name of company	Debt Equity Ratio		Interest Coverage Ratio		Difference	
	Pre Merger X1	Post Merger Y1	Pre Merger X2	Post Merger Y2	D1=Y1-X1	D2=Y2-X2
Idea cellular	2.42	0.68	2.51	2.32	-1.74	-0.19
Vodafone	0.23	0.35	-10.1	4.8	0.12	14.9
Tata Teleservices	1.11	1.76	1.92	1.13	0.65	-0.79
Bharti Airtel	0.45	1.26	36.73	3.32	0.81	-33.41
Telenor	0 .55	0.30	7.81	9.38	-0.25	1.57
					∑D1=-0.41	∑D2=-17.9

Source: Data compiled from annual reports of the Selected Companies

Table 4 indicates the Average Debt Equity ratio and Interest Coverage ratio of the selected companies 2 years before and after the merger. In the pre merger period, Idea Cellular showed the highest Average Debt Equity ratio of 2.42 followed by Tata Teleservices being 1.11, while for Vodafone, Bharti Airtel and Telenor, Debt equity ratio accounted for 0.23, 0.45 and 0.55 respectively. In the post merger period, the average Debt Equity ratio of Idea Cellular decreased to 0.68 and that of Telenor to 0.30. On the other hand, the remaining 3 companies showed an increase in the average Debt Equity ratio. Similarly, in the pre merger, Bharti Airtel showed a highest Average Interest Coverage ratio of 36.73 followed by Telenor at 0.56. For the remaining three companies including Idea cellular, Tata Teleservices and Vodafone, the Interest Coverage ratio amounted to 2.51, 1.92 and -10.1 respectively. In the post merger period, the Average Interest Coverage ratio of only Telenor and Vodafone improved. However, there was a decline in the Average Interest Coverage ratio of the remaining 3 companies. The total average difference between the pre and post merger Debt Equity ratio and Interest Coverage ratio for all the selected companies figured at -0.41 and -0.17.91 respectively. Thus, this indicates that on an average, the solvency position of the selected companies did not improve after merger and acquisition

Table 5:t- Test Analysis of the Selected Companies- Solvency Ratios

Test Statistics	Debt Equity Ratio		Interest Coverage Ratio	
	Pre-merger	Post-merger	Pre-merger	Post-merger
N	5	5	5	5
Mean	0.95	0.87	7.77	4.19
Variance	0.77	0.39	304.97	10.23
P	0.87		0.67	
A	0.05		0.05	
Result	H_0		H_0	

At the given level of significance α= 0.05, P> α, there is no evidence that the mean scores for the companies differ, hence we fail to reject the null hypothesis.

Table 6: Average Profitability ratios of the Selected Companies before and after merger

Name of company	Net profit ratio		EPS		ROCE		RONW		D1=Y1 -X1	D2=Y2-X2	D3=Y3 -X3	D4=Y4 -X4
	Pre X1	Post Y1	Pre X2	Post Y2	Pre X3	Post Y3	Pre X4	Post Y4				
Idea Cellular	9.28	8.04	1.46	3.04	14.42	35.25	27.78	7.53	-1.24	1.58	20.83	-20.25
Vodafone	-46.05	26.95	-4.56	2.03	-11.8	5.85	-15.42	8.77	73.45	6.59	17.65	24.19
Tata Teleservices	-14.44	-5.35	-1.19	-0.65	39.18	32.82	-9.53	-4.77	9.09	0.54	-6.36	4.76
Bharti Airtel	10.55	7.515	18.91	13.57	68.42	27.79	28.31	9.535	-3.035	-5.34	-40.63	-18.77
Telenor	16.46	11.19	27.79	19.61	14.99	10.07	22.93	12.92	-5.27	-8.18	-4.92	-10.01
									∑D1=72.995	∑D2=-4.81	∑D3=-13.43	∑D4=-20.08

Source: Data compiled from annual reports of the Selected Companies

Table 6 indicates the two year pre and post merger averages of the profitability ratios of the selected companies. From the pre merger period to the post merger period, Vodafone showed a maximum increase in the Net Profit ratio as it increased to 26.95% followed by Tata Teleservices which improved after the merger. However, the remaining 3 companies experienced a decline in the Net Profit ratio. The EPS of Idea cellular, Tata Teleservices and Vodafone improved after merger whereas it showed a decline for Bharti Airtel and Telenor. On the other hand, the return on capital employed showed a lot improvement after the merger for Idea cellular and Vodafone as it increased by 20.83% and 17.6% respectively while the remaining 3 companies showed a decline. The return on net worth of Vodafone showed a maximum increase as it increased by 24.19% followed by Tata Teleservices whose RONW increased by 4.76%. However, the remaining 3 companies showed a decline in RONW. The total average difference between the pre and post merger Net Profit ratio, EPS, ROCE and RONW for all the selected companies figured to 72.995,-4.81, -13.43 and -20.08 respectively. Thus, this clearly indicates that on an average the profitability position of the selected companies did not improve after merger and acquisition.

Table 7: t- Test analysis of the Selected Companies - Profitability Ratios

Test Statistics	Net Profit Ratio		Earnings Per Share		Return on Capital Employed		Return on Net Worth	
	Pre-merger	Post-merger	Pre-merger	Post-merger	Pre-merger	Post-merger	Pre-merger	Post-merger
N	5	5	5	5	5	5	5	5
Mean	-4.93	9.67	8.482	7.52	25.04	22.35	10.81	6.797
Variance	679.40	133.45	198.62	74.93	913.18	182.16	460.71	45.80
P	0.30		0.67	0.90	0.86		0.70	
A	0.05		0.05		0.05		0.05	
Result	H_0		H_0				H_0	

At the given level of significance α= 0.05, P> α, there is no evidence that the mean scores for the companies differ, hence we fail to reject the null hypothesis.

Conclusion

Overall, the result of the study indicated that though the companies may have been able to leverage the synergies arising out of the merger and acquisition deal, but they have not been able to improve their liquidity position, which is visible from the decreasing Current ratio in most of the cases excluding Bharti Airtel and Vodafone. The Profit Margin also did not show much improvement after the merger, which is a very important tool as it helps to show the effect of merger on the profits of the company and to justify the decision taken by the management to the shareholders. Also, the solvency position of firms was negatively affected by the merger activities.

The result of the t-Test conducted showed that there was no difference between the mean score of the various ratios calculated in the pre and post merger period. This proved that overall the financial performance of the telecom companies did not improve in short run after the merger and acquisition.

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