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Corporate Restructuring and its Effect on Economic Value Added of Some Select Indian Companies – A Study

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Abstract

The process of mergers and acquisitions has gained substantial importance in today's' corporate world and used extensively for restructuring the business organizations. The increased competition in the global market has prompted the Indian companies to go for mergers and acquisitions as an important strategic choice. Indian corporate enterprises are refocusing in the lines of core competence, market share, global competitiveness and consolidation. The immediate effects of the mergers and acquisitions have also been diverse across the Indian IT and ITeS and other sectors of the Indian economy which have proved their potential in the global market. Increased participation of the Indian companies in the global corporate sector has further facilitated the merger and acquisition activities in India. The present paper is an attempt to understand the Economic Value Added and its effect due to the merger of some of the selected Indian companies.

Keywords: *Bidder Firms, Economic Value Added, Event Year, Hypothesis Testing, Merger,*

I. INTRODUCTION

The ever-growing economies of the globe have increased manifold by merging with the firms of the same discipline or with related sectors. Mergers and Acquisitions have become a fundamental area of corporate strategy and the post liberalization regime witnessed a surge in this phenomenon, giving it a new dimension in the global economy. Indian enterprises were subjected to strict control regime before 1990s that resulted to haphazard growth of Indian corporate enterprises during that period. The reforms process initiated by the Government since 1991, has influenced the functioning and governance of Indian enterprises which has resulted in adoption of different growth and expansion strategies by the corporate enterprises by adopting the mergers and acquisitions policies. The process of mergers and acquisitions has gained substantial importance in today's' corporate world and used extensively for restructuring the business organizations. It has become an important instrument for expanding the product portfolios, exploring new markets, gain access to research and development and gain access to resources which would be helpful for it to complete in the global arena. The increased competition in the global market has prompted the Indian companies to go for mergers and acquisitions as an important strategic choice. Indian corporate enterprises are refocusing in the lines of core competence, market share, global competitiveness and consolidation. The major industries focused in cross-border Mergers and Acquisitions during 1995 to 2000 have been consumer goods and services, pharmaceuticals and healthcare and energy which together accounted for 66% of cross-border activity. IT services and electronics and high technology industries accounted for more than half of cross-border transactions post-2000.

II. SURVEY OF LITERATURE

Rani, Yadav and Jain (2013)in their study compares performance of the corporate involved in Mergers and Acquisitions before and after such activity and found that the key hypothesis is that acquiring firms have improved post-event operating performance. The findings suggest that profitability of acquiring firms has improved during post-merger phase. Mergers and acquisitions have resulted in better and improved performance. ***Singh (2013)*** tries to capture the performance of 20 public limited companies listed on the stock exchange through the comparison of financial ratios and analysed that there was significant increase in the mean operating profit margin, net profit margin ratios, return on net worth and return on capital employed after the merger. ***Duggal*** *(2015)* examined the impact of mergers on the financial performance of Indian banks and also investigated the sustainability of the impact of merger after the event date. Only public sector bank mergers were considered for investigation. The mergers in banking sector announced between the years January 2001 to December 2006 were considered for the study. On analyzing the given ratios for a period of 3-year pre and 5-year post it became evident, that major impact was seen in terms of return to assets ratio as maximum banks in the samples showed significant results. To conclude, mergers proved to have a propound effect on banks' ability to earn profits and building on assets for future growth. ***Shorewala and Chaudhary (2016)*** identified the implications of Make in India initiatives on the restructuring strategies of different firms in India. Even though the country suffers from various obstacles, the aforesaid initiative promotes domestic manufacturing coupled with tax concessions and comparatively cheap labor appear as a good reasons to attract more multinationals in India.

III. RESEARCH GAP

The studies that have been enumerated here and others, have tried to emphasize on the operating performance of the companies and have considered the Balance Sheet figures for the ascertaining the performance differential. It is found that only considering the operating performance as the indicator of improvement does not reveal the true nature of the merger effect. Economic Value Added (EVA) is another dominant tool which shows how the company performance is to be achieved over the coming years. The present study is an attempt to understand how the Economic Value Added has changed over the years for some selected Indian companies from various sectors and whether the merger has brought any result in any structural break in the Economic Value Added due to this event.

IV. OBJECTIVES OF THE STUDY

The present study tries to fulfill the following objective -

- It tries to find whether the firms have registered a positive Economic Value Added and whether there is any significant change in the pre and post event years with respect to the same.

V. RESEARCH METHODOLOGY

The study focuses mainly on the acquiring firms' Economic value Added and its behavior over the years due to the merger. This chapter is the fundamental framework on which the study is based and is divided among the following sections:

- **5.1 DATA SET**

The data set used in the study is for five companies which have undergone merger in2008-2009. The companies are listed in both BSE and NSE. The details provided in the **Table – I** shown below.-

S.No.	Name of the Company	Date	Acquirer	Target
1	Sunteck Realty	21/07/2008	Sunteck Realty Ltd	Amrut Consultancy Pvt Ltd
2	Birla Precision	22/10/2008	Birla Precision Technologies Ltd	Zenith Birla (India) Ltd
3	Colgate-Palmolive	16/12/2008	Colgate-Palmolive (India) Ltd	SS Oral Hygiene Products Pvt Ltd
4	Reliance Petroleum	02/03/2009	Reliance Industries Ltd	Reliance Petroleum Ltd
5	Asian Paints	30/03/2009	Asian Paints Ltd	Technical Instruments Manufacturers (India) Ltd

- **5.2 TOOLS AND TECHNIQUES**

The data is considered for five companies which have had mergers in the year 2008-2009. The hypothesis has been set for carrying out a t-test. The pre merger years are 2004to 2008 and post-merger years are from 2010 to 2014 for 2009 as the event year. Firstly, Economic Value Added (EVA) is calculated and subsequently t-test is applied to draw the necessary inferences.

- **5.3 HYPOTHESIS**

H_0= There is no significant change in the Economic Value Added in the post event era.
H_1= there is a significant change in the Economic Value Added in the post event era.

VI. ANALYSIS AND FINDINGS

The companies selected are both listed on NSE and BSE and have been considered for Economic Value Added(EVA) calculation. The following formulas were used for deriving the same.

Return on Equity= Equity Earnings /Average equity
= Profit after Tax/ (Equity + Reserves)____________________________ **1.1**
Growth Rate = 1x Payout Ratio x Return on Equity______________________________ **1.2**
Cost of Equity = Dividend in the next period/ (Current Market Price+ Growth Rate) ____ **1.3**
Economic Value Added= Profit after Tax-(Cost of Equity x Equity Capital) ___________ **1.4**

The Economic Value Added data is then analyzed through t-test to understand whether there is any significant change in the pre and post event years.

Table II: Mean EVA of selected Companies (in pre and post-merger years)

S.No.	Name of the Company	Mean EVA (Pre-merger years) X	Mean EVA (Post-merger years) Y
1	Sunteck Realty	0.6260	33.88538799
2	Birla Precision	3.3113	6.53
3	Colgate Palmolive	149.7088371	461.4571146
4	Reliance Petroleum	10626.6152	19878.9258
5	Asian Paints	229.1205	944.3214749
Source: Self computed by the Author(s)			

The test statistic is **$t = \bar{d}/ S/\sqrt{n-1}$**, where **$\bar{d}$** and **S** denote respectively the mean and standard deviation of the Differenced$_i$ i.e.**$\bar{d}= \sum d_i/n$** and **$S^2 = \sum d_i^2/n - [\sum d_i/n]^2$**

Table III: Calculation for t-test analysis of Economic Value Added

Name of the Company	x	y	d=x-y	d^2
Colgate- Palmolive	149.7088371	461.4571146	-311.748277	97186.98852
Reliance Industries	10626.6152	19878.9258	-9252.31062	85605251.81
Sunteck Realty	0.6260	33.88538799	-33.259388	1106.18689
Asian paints	229.1205	944.3214749	-715.201023	511512.503
Birla precision	3.3113	6.53	-3.21874377	10.36031148
			∑d=-10315.7381	**∑d2=86215067.85**

$\bar{d}$ = -2063.14761; S^2 = 12986435.51; S = 3603.6697
T = $\bar{d}/ S/\sqrt{n}$: -1-0.28625648
Here, t = -2063.14761/3603.6697/√5-1
= -0.2862

Source: Self computed by the Author(s)

From the above table the observed value is -0.2862 and the critical region for 1% level of significance and 4 degrees of freedom is $|t|\geq 4.032$, therefore we cannot reject the H_0 and it can be concluded that there is no significant change in the mean operating profit after the merger event.

CONCLUSION

The present study has been an attempt to understand the pre and post event effects in some selected Indian companies in relation to the Economic Value Added (EVA). It is considered to be one of the most important parameters for performance evaluation of a concern since it is the residual profit after deduction all other charges including the opportunity cost of capital. It was found that the mean Economic Value Added of the companies considered for the study has not changed and the merger has not created any synergistic benefits for the organization.

Further, it was also observed that the companies had gone for the merger for attaining economies of scale but this motive was also not fulfilled due to absence of proper distribution channels and marketing strategies. The mergers have in many cases failed to capture the advantages which were expected to attain and as a result have led to negative gains for the bidder firms. In the above study, the companies considered for the analysis were the bidder firms and it was found that they were not benefitted due to the merger. This has also been substantiated by previous studies and the target firm shareholders turn out to be the gainers from this type of corporate strategy.

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