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A REVIEW OF POST-ACQUISITION FINANCIAL PERFORMANCE OF SOME SELECTED INDIAN PHARMACEUTICAL COMPANIES

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Abstract

Merger and Acquisition is one of the most researched areas in the field of finance, economics and strategic management. The post-merger performance of firms has for long been an area of study and research and still an ongoing one. Whether mergers are wealth-creating or wealth-reducing events is still debatable. In this context, it is important to assess whether mergers have led to better performances of merged units, because only such an improvement can justify the use of mergers as an important corporate strategic tool. In this backdrop, the present study is a humble attempt to examine the post-merger performance of some selected Indian pharmaceutical companies that have gone through the process of merger and acquisition over a period of time in order to observe whether the process of merger and acquisition had any significant impact on the post-merger operating and financial performance of the acquirers. The study reveals that the acquirers have failed to produce synergy during the post-acquisition period.

Key Words: Mergers and Acquisitions, Post-Merger Performance, Operating and Financial Synergy

I. Introduction

Liberalization in Indian economy since 1990s has made the competition global to the Indian corporates. As a result of scaling down of the import barriers and entry of multinationals, the new mantra has become "beat them, else join them". Growth has become the fulcrum of every business which can be achieved either internally (by increasing investment) or externally (through corporate mergers and acquisitions). The second option was considered superior to the corporate entities. Synergy is popularly cited as one of the prime reasons for planning mergers and acquisitions.

At present, the Indian pharmaceutical industry is positioned in the top ranks amongst the developing nations. Health has no boundaries. This makes the sector one of the mergers and acquisitions favourites. Over the past few years companies like Ranbaxy, Wockhardt, Cadila, Matrix, Jubilant etc. have targeted developed markets in their pursuit of growth by making one or more international acquisitions, while others are also searching for potential targets. Besides gaining a faster entry into the target market, one of the basic strategies behind the acquisitions is to take the advantage of India's low cost infrastructure by shifting the manufacturing base to India.

II. Review of Literature

Contributors Key Findings

Singh (1971) 75% of the merged companies, included in the sample, reported lower profitability from the third year subsequent to the merger

Utton (1974) Average profitability was significantly lower for the merged group than their unmerged counterpart

Meeks (1977) Except for the first post-merger year, in all other years up to the seventh year, average profitability had declined

Ikeda & Doi (1983) Mergers improved profitability, efficiency, firm growth, and R&D in Japanese manufacturing industries

Ravenscraft & Scherer (1989) A significant negative impact of 13.34% on the post-merger profitability was found

Agrawal, Jaffe & Mandelker (1992) Stockholders of acquiring firms suffered a significant loss of about 10% over the five-year post-merger period.

Healy, Palepu & Ruback (1992) Merged firms showed significant improvements in asset productivity relative to their industries, leading to higher operating cash flow returns

Cornett & Tehranian (1992) Significant increase in post-merger performance was found as compared to pre-merger

Switzer (1996) Mergers led to synergistic gains and better performance in the long-run

Dickerson, Gibson and Tsakalotos (1997) Both in short-run as well as in long-run acquisitions had a negative impact on the profitability of the acquirer firm

Beena (2000) Did not find any evidence of improvement in the financial ratios during the post-merger period

Manson et. al. (2000) Takeovers had led to operating gains ranging from 2 per cent to 14 per cent per year post-merger

Pawaskar (2001) Acquiring firms performed better than industry average in terms of profitability

Ghosh (2001) Cash flows of merging firms increased significantly by 2.4 percent every year

Kaur (2002) Both profitability and efficiency of acquirer companies declined post-merger, but such decline was statistically not significant

Ramaswamy & Waegelein (2003) Post-merger operating financial performance of the merged firms had improved significantly

Rahman & Limmack

(2004) Improvements in operating cash flows of 3.75 per cent per year after the merger was found

Mantravadi & Reddy

(2008) Minor variations in terms of impact on operating performance following mergers in different industries in India was noticed

It is evident from literature review that the findings of the research works show mixed results in terms of improvement of post-merger financial performance of firms.

III. Objective of the Study

The basic objective of this study is to assess the post-acquisition performance of some selected Indian pharmaceutical companies involved in mergers and acquisitions during 2000 to 2007 on the basis of some financial parameters.

IV. Methodology

Sample Selection: First, the top 50 Indian pharmaceutical companies are selected based on their market capitalization. Second, out of these 50 companies, 23 companies, which were engaged in the process of acquisition during the period 2000 to 2007, are considered in the preliminary list. Other 27 companies don't have any mergers and acquisitions records during the said period. Out of these 23 companies, one company has been excluded because of non-availability of three years' pre-merger financial data which is necessary for the analysis. Further, 5 companies, which have been engaged in further M&As within three post-merger years are eliminated from the list as any subsequent acquisition made by the acquirers during post-acquisition period under study may have some impact on their overall post-merger performance. Thus, finally 17 such companies are selected. Name of these companies are Dabur India Ltd., Cadila Healthcare Ltd., Piramal Healthcare Ltd., Glenmark Pharmaceuticals Ltd., Torrent Pharmaceuticals Ltd., Aurobindo Pharma Ltd., Matrix Laboratories Ltd., Fresenius Kabi Oncology, Dishman Pharmaceuticals & Chemicals Ltd., Unichem Laboratories Ltd., Wockhardt Ltd., Plethico Pharmaceuticals Ltd., Merck Ltd., Nectar Lifesciences, Indoco Remedies Ltd., Natco Pharma Ltd. And Bliss GVS Pharma Ltd.

Data Collection: Data required for this analysis are secondary in nature i.e. they are taken from already published sources. Financial data for these 17 companies are obtained from their annual reports and from summarized financial statements obtained from different authenticated websites for the specific years. The event year (i.e. the year in which the acquisition under study took place) is being excluded as it usually includes a number of events which might influence a firm's economic performance.

Selection of Financial Parameters: For the purpose of selection of different financial parameters to be used for the analysis we have referred to those financial parameters which are considered by various leading domestic and international credit rating agencies. As per the recommendations of Credit Rating Information Services of India Ltd. (CRISIL), the oldest of the credit rating agencies in India, the eight financial parameters for the purpose of assessing the overall financial health of a manufacturing company, including pharmaceutical company, are comprised of 8 parameters viz. Capital Structure Ratio or Gearing Ratio, Interest (& Dividend) Coverage Ratio, Cash Debt Service Coverage Ratio, Tangible Net Worth, Profitability Margin, Return on Capital Employed, Net Cash Accrual to Total Debt and Current Ratio.

We have also taken the financial ratios considered by another leading credit rating agency namely Standard & Poor (S&P) in determining their published ratings in the US for our analysis. These ratios are Pre-Tax Interest Coverage Ratio (EBIT / Interest), Cash Flow from Operations to Long-Term Debt, Cash Flow from Operations to Total Debt, Earnings before Taxes to Permanent Capital (i.e. Return on Net Worth), Operating Income to Sales, Capital to Long-Term Debt, Capital plus Short-Term Debt to Total Debt and Equity to Total Liabilities.

Besides these, we have also considered two more ratios which are commonly used in the leading studies in this context. These are: Operating Cash Flow to Total Asset and Operating Cash Flow to Sales.

Thus, the final list consists of 18 different financial parameters. These parameters are then calculated by applying the standard formulae for each company for the relevant periods under study.

Data Analysis: The analytical part, in this thesis, is subdivided into two parts viz. Company Specific Analysis and Ratio Specific Analysis.

Company-Specific Analysis: Under company specific analysis, first, the selected companies are taken up for study individually. Then, all the stated 18 financial parameters are calculated for each company separately for three years prior to and three years subsequent to the merger year. Pre-merger and post-merger averages of these financial parameters are then compared to identify any significant improvement during the post-merger period. Population proportion tests have been conducted company-wise to see whether majority of the financial parameters taken up for study have been improved during post-merger period. Since, the sample size is small (only 18 financial parameters) exact binomial tests (with $p = 0.5$) are conducted in place of z-test.

Ratio Specific Analysis: The performance of the selected companies are evaluated by applying the non-parametric Wilcoxon signed rank test (WSRT) to observe whether there is any significant improvement in the post-merger financial performance of the acquirer companies as far as a particular financial parameter is concerned.

V. Outcome of the Analysis

Company-specific Analysis and its Outcome: As stated earlier, company-wise exact binomial tests (with a null hypothesis that majority of the parameters are not improved post-merger against the alternative hypothesis that majority of the parameters improved post-merger) are conducted. The results of these exact binomial tests reveal that only for seven out of seventeen companies, majority of the financial parameters showed improved performance during post-merger period which is not a significant figure as per the exact binomial test.

Ratio-specific Analysis and its Outcome: The performance of 17 sample companies are evaluated with respect to each of the 18 financial parameters by applying the non-parametric Wilcoxon signed rank test (with null hypotheses of no changes in financial performance pre and post-merger against the alternative hypotheses of improvement of financial performances during the post-merger period as compared to pre-merger period) to observe whether there is any significant improvement in the post-merger financial performance of the acquirers as far as a particular financial parameter is concerned. The results of Wilcoxon signed rank tests reveal that except for tangible net worth the post-merger financial performance of the selected companies with respect to any other financial parameter has not been seen to be improved as compared to their pre-merger performance. This is quite obvious that after acquisition of a company, the net worth of the acquirer company generally improves. The results of these tests are revealing the same fact.

VI. Summary of Findings and Conclusion

In conclusion, it may be stated that, the overall position of the selected pharmaceutical companies included in the sample have not been significantly improved during post-merger as far as these financial parameters are concerned except for a few isolated cases. Thus the study establishes the fact that the selected companies can barely make any significant financial synergy out of the acquisitions made by them.

VII. Limitations of the Study

Following are some of the limitations of the study, which deserve mentioning:

i. The study is limited to a sample size of 17 companies which have undergone mergers and acquisitions during the selected period. Inclusion of more number of sample units might have produced different results.

ii. Only three years' pre-merger and post-merger data are undertaken for the study. Consideration of a longer pre-merger and post-merger period might have produced more appropriate results.

iii. The study has also ignored the impact of possible differences in the accounting methods adopted by different companies included in the sample.

iv. The analysis is made on the basis of financial data only. Qualitative aspects such as organizational cultures etc. are ignored.

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