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A Nexus Between Mergers & Acquisitions and Financial Performance of Firms: A Study of Industrial Sector of Pakistan

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Abstract

Mergers and Acquisitions (M&As) have gained considerable interest in the last few decades and the purpose behind these events is to increase revenues, gain market share, achieve competitive edge and aimed to diversify the risk. This study aims to investigate the role of mergers and acquisitions on the financial performance of firms in the industrial sector of Pakistan. Financial Performance is measured on the basis of the stock market performance of the firms, which has been measured using the event study methodology as this is one of the recognized techniques in the conditions of M&As. Stock market performance is measured in the short as well as long term. In the short term, Abnormal and Cumulative Abnormal Returns are measured and in the long-term Buy-and-Hold Abnormal Returns (BHAR) are assessed. Furthermore, for robustness, the financial performance is analyzed by using accounting method in which Return on Assets (ROA), Return on Equity (ROE), Net Profit Margin (NPM) and Earning per Share (EPS) has been measured. The results of this study revealed that the occurrence of M&As negatively affected the firms' financial performance for the industrial sector of Pakistan in the short term and long term as well and the market did not respond to these events and impacted negatively on shareholders' wealth and financial performance of firms. This study concluded that the Pakistani stock market does not react to the events of M&As in the short and long run as well, it neither created nor destroyed Shareholders' wealth and no such financial affects for the acquired firms. Further, this study suggested that the industrial sector of the country should adopt different strategies to expand their businesses or to gain competitive advantage.

Keywords: mergers and acquisitions, event study, buy-and-hold abnormal returns, return on assets, return on equity, net profit margin and earning per share

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Introduction

Mergers and Acquisitions (M&A) have achieved substantial interest in academic research. Most of empirical researches focus on the stock returns in the short term near the announcement days. Only a fewer studies analyze the long term performance of stock returns (Dutta & Jog, 2009). Merger can be defined as combination of two or more entities while in the case of acquisition; this combination is carried out in such a way that the one organization exists while the other entity is dissolved. The objective behind these mergers and acquisitions are to enhance revenues, gain market share, achieve competitive advantage and diversify products and risk (Fatima & Shehzad, 2014). In acquisitions the organizations purchase the capital shares of other company, in addition to this acquisitions can also be carried on if an individual possesses majority of the shares and interest in affairs of the management (Mariappan, 2003). These events are of the significance importance for the entities to acquire assets, gain growth, market expansion that leads towards higher returns and profitability (Martynova & Renneboog, 2006). After the financial crises globally, the occurrence of M&As speed up just not to achieve competitive advantage but it was also due to the firms' survival and to have a grip in particular industry. This had transformed the structures of businesses significantly (Fatima & Shehzad, 2014).

These M&As are of various forms including; buyouts, takeovers, divestments, minority acquisitions. These all have different motives, challenges and different characteristics (Faulkner, Teerikangas, & Joseph, 2012). So, M&As can be of the different forms having different motives and dynamics and all these forms have different implications on the parties involved i.e acquirer and target. But all these forms of M&As have one similar aim to create value from these events in some or other form. M&As deals are carried out with various objectives. The previous studies have shown various motives behind the occurrence and have used various frameworks based on theories (Bower, 2001; Haleblian, Devers, McNamara, Carpenter, & Davison, 2009). Those studies relate those motives on the basis of strategic, financial and managerial (Faulkner et al., 2012; Napier, 1989). Concerning financial motives, in which M&As emphasizes to improve and expand the value of the firm with the help of cost-based synergy by the economy of scope and scale or with the help of revenue-based synergies which concentrate on improving the sales with help of assets growth (Eccles, Lanes, & Wilson, 1999).In Revenue-based synergy, the main intention is the collaboration between the acquirer and target firms by merging up their process and assets which include the resources and knowledge sharing (Capron, 1999).

A growing trend of mergers and acquisitions has been observed in Pakistan over the years, 50% of this trend is associated with the financial sector in Pakistan (Tauseef & Nishat, 2014). M&As are mostly interested in the telecom and industrial sector of Pakistan (CCP, 2016) and have become monitorial stakeholders of these sectors within a few past years. Various studies have been conducted in the financial sector of Pakistan particularly in the banking sector's performance with respect to pre and post mergers and acquisitions regimes. Secondly, the occurrence of M&As and these events impact on stock market returns as it generates abnormal returns, resultantly it is essential to measure the effect of such events on the wealth of shareholders. The occurrence of M&As in the Pakistan is limited and event size is too small, although the researches are conducted in the financial sector of Pakistan but according to our best esteem, no such study has been conducted to address the events related to the industrial sector of Pakistan.

The major concern of this study is to find effect of these events on the wealth of shareholders and also on firms' financial performance. As a whole this study intend to measure the pre and post effect of M&As in the short term and long term and to analyze these synergies' impact on shareholders' wealth. To achieves these research objectives, this study has applied the event study methodology which was formally introduced by Dodd and Warner (1983) and improvised by Barber and Lyon (1997). Thirdly, for Robustness check, accounting method has been applied to evaluate the financial indicators of the firm including; Return on Assets (ROA), Return on Equity (ROE), Net Profit Margin (NPM) and Earning per Share (EPS).

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Literature Review

The procedure of acquisition is the buying of overall or major assets of any other company (okonkwo, 2004); with the adoption of such a strategy, the decision making authority is transferred to the acquiring company. It's explained that the consolidation via acquisition states that the shareholders of procured company are paid up with the help of cash and ownership of the shareholders are transferred and they are no more owner of the company (okonkwo, 2004). There are two main consequences of Acquisition; either the newly acquired entity is amalgamated into a single entity or it continues to perform as a different institution under the new possession (pilloff & Santomero, 1996). According to author the adoption of merger consequences in assets sharing, whereas the shareholders of both combined entities still enjoy a bit of ownership in newly formed entity. But in adoption of acquisition a complete change occurs in the ownership mechanism or the ownership structure is handed over to the new entity (okonkwo, 2004).

The acquisition procedure also involves the vital decision of re-structuring and shifting of working staff. Organizational Justice Theory delivers essential theoretical sensitive about the influence of such decisions on the perception and behavioral pattern of the surviving employees (Mohammed, 2011). During the merger process, employees obeserve how the decisions are taken and how they are helpful in the regard of distributive and technical malpractices (Greenberg, 1987). More often Merger negotiation are restricted to top leadership and management of the combining firms, but, the information in some cases however leak down to the lower staff by the organizational hierarchy. Such leakage of information may result in generation of gossips and rumors about the merger which may lead in creating an environment of suspicious and concerned among the employees about their futures as anxiety among the employees is reportedly at peak during the merger (Buono & Bodwdich, 1989). Such an environment of anxiety would likely affect their careers, jobs and livings (Marks & Mirvis, 1992). Nevertheless, such a situation can be avoided if the important decisions are officially announced by the firm's management about the merger, its effect and the future plan after the merger and specially the implications of merger on employees (Marks & Mirvis, 1992).

Zola and Meier(2008) analyzed the 88 empirical researches conducted in between 1970 to 2006, in their study; they stated twelve different methods in their study to measure the effect of M&As on the wealth of shareholders. In those papers, 41% of the researchers had used the event study methodology for analyzing post-merger returns, 28% researchers had used long term accounting method for analyzing the post-merger returns. The other methodologies included the proxies of financial returns including: operating efficiency improvement, post-merger productivity, revenue growth, and customer satisfaction and retention. The most widely used approach for analyzing the post-merger performance is the examination of the abnormal stock returns to the stockholders for both the target and bidder firms near to the announcement of the M&As, it also includes both successful and unsuccessful events, it is called as event study as this happens due to occurrence of certain announcement. The accounting methodology, which is second most used methodology measures the post-merger returns after the completion of events and analyze returns in the long run (M Zollo & Meier, 2008).

Research Method

Firstly, this study aims to find the mergers and acquisitions (M&As) effect on the firms' financial performance in terms of shareholders' returns. To achieve this objective, the event study technique has been used to compute the financial performance of acquired companies. Event study evidence back to stock split study in 1969 introduced by Fama, Fisher, Jensen, and Roll (Binder, 1998).The event study technique in current state was initiated formally by Dodd and Warner (1983) , Brown and Warner(1985) and further this technique was extended by Barber and Lyon (1997). This technique is based on two steps, in the first step the short term impact of announcements is measured by assessing cumulative abnormal returns represented by CARs for the firms' stock returns. While in the second step the long term performance of firms is measured by analyzing the Buy-and-Hold Abnormal Returns (BHAR). Financial researches use this approach to analyze the stock market returns related to certain event (Corrado, 2011). This technique is also used in the Mergers and acquisitions events, so that the short term impact and the long term impact of these events can be assessed to measure the synergies impact on performance of firms in terms of stock market returns (Kiesel, Ries, & Tielmann, 2017). Secondly, the aim of this study is to analyze the effect of these events on the firms' financial performance using financial ratios of the firms for which profitability ratios including: Return on Assets (ROA), Return on Equity (ROE), Net Profit Margin (NPM) and Earnings Per Share (EPS) has been assessed. The accounting method has been applied to analyze this impact by evaluating three years pre and post financial ratios of the firms under study in the industrial sector of Pakistan.

Table 1. Events Under Study.

Event	Acquirer	Target	Type	Date of M&As
E1	Bestway Cement Limited	Pakcem Limited	Merger	06/06/2017
E2	Gadoon Textile Mills Limited	Fazal Textile Mills Limited	Merger	04/12/2015
E3	Exide Pakistan Limited	Automotive Battery Company Limited	Merger	04/05/2009

**Events source is Pakistan stock exchange and competition commission of Pakistan*

Data Analysis & Interpretation

Short Term Analysis

The Abnormal return for the event 1, 2 and 3 are positive at the event date, While the cumulative abnormal return of the event 2 and 3 are positive on the announcement date of mergers and acquisitions and CAR for the event 1 is negative on the announcement date of event. The difference of pre and post results for ARs was found negative in an event window of 91 days (-45, +45) for Events 2 and 3, while the CAR for both the events are positive having values 2.14% and 12.68% respectively. The event 1 has positive Abnormal Return having value of 0.06% but it shows negative CAR of -2.49%.

Below figure show the graphical representation of CARs for the industrial sector of Pakistan. On announcement date event 2 and 3 show positive incline in returns while the event 1 show negative incline in returns. The Post M&As Events show a decline in the shareholders wealth for the first twenty days of occurrence of event but later after 30 days it can be seen that event 2 and 3 are inclining towards positive results for investors providing a cause to analyze these events in longer term which has been done later in this section with the help of Buy-and-Hold Abnormal Returns.

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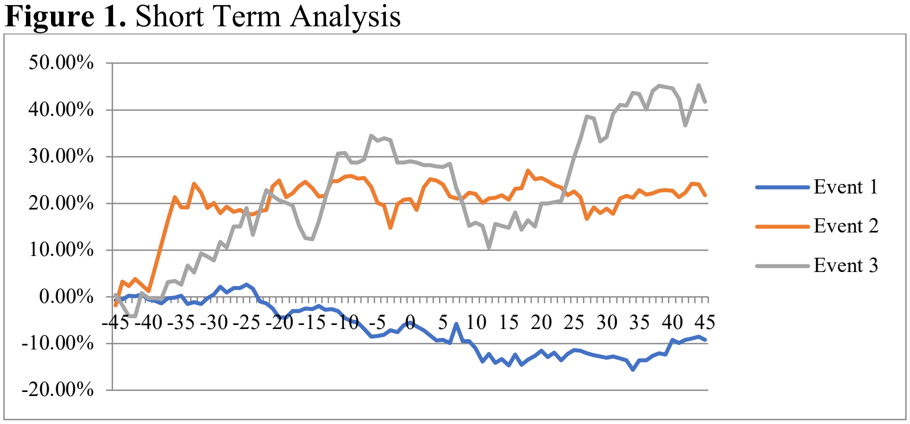
The values of the t statistics for the industrial sector of Pakistan are statistically insignificant as stated in the Table 2. The t statistics value for the event 1 is -0.679, it is 1.128 for the event 2 and the event 3 has value of 1.457. This validate that these results are statistically insignificant and could not create value for the shareholders in industrial sector of Pakistan with in estimation window of 91 days. This can be said that event of the Mergers and Acquisitions have affected negatively on the shareholders wealth and the firm financial performance in the industrial sector of Pakistan in the short-term period for the window of 91 days (-45. +45). These results stat that the occurrence of M&As did not create value for the shareholders in the 91 days estimation window.

Table 2. AR and CAR Differences

S.No	Returns	Announcement day	Pre Event returns	Post event returns	Difference
Event 1 (Bestway Cement Limited- Pakcem Limited)	Average Abnormal Return	0.56%	-0.13%	-0.07%	0.06%
	Cumulative Abnormal Return	-5.06%	-5.63%	-8.12%	-2.49%
Event 2 (Gadoon Textile Mills Limited- Fazal Textile Mills Limited)	Average Abnormal Return	0.21%	0.49%	0.04%	-0.44%
	Cumulative Abnormal Return	22.09%	21.88%	24.02%	2.14%
Event 3 (Exide Pakistan Limited- Automotive Battery Company Limited)	Average Abnormal Return	0.25%	0.63%	0.28%	-0.36%
	Cumulative Abnormal Return	28.68%	28.43%	41.11%	12.68%

Figure 1. Short Term Analysis



In 11 days estimation window results interpret that all the events has positive abnormal returns on the event day of occurrence of M&As it shows that the market responded well to the occurrence of event and created synergistic gain for the shareholders on the announcement of the event day. The CAR for the event 1 is 3.05%, Event 2 has negative CAR -2.40% and the CAR for the event 3 is -5.49%.

While looking at the differences of pre and post-performance of firms, mix results can be viewed for event 1 both the AR and CAR are negative, event 2 has positive AR and CAR and the event 3 has Positive AR and Negative CAR in the 11 days estimation windows, Significance value in the tale 4.8, shows that the, t value for all the events are statistically insignificant and did not created significant results for the shareholders. Further, the graphical representation in Figure 5.4 shows that the events 1 and 3 have negative cumulative abnormal returns, while only event 2 had positive

CARs but which are statistically insignificant. These results match with the 91 days estimation window which also showed negative results for the industrial sector of the country and did not created value for the firms in the 11 days estimation window.

Table 3. 11 Days Estimation Window

S.No	Returns	Announcement day	Pre Event returns	Post event returns	Difference
Event 1 (Bestway Cement Limited- Pakcem Limited)	Average Abnormal Return	0.56%	0.50%	-0.70%	-1.20%
	Cumulative Abnormal Return	3.05%	2.49%	-0.47%	-2.96%
Event 2 (Gadoon Textile Mills Limited- Fazal Textile Mills Limited)	Average Abnormal Return	0.21%	-0.52%	0.64%	1.16%
	Cumulative Abnormal Return	-2.40%	-2.61%	0.79%	3.40%
Event 3 (Exide Pakistan Limited- Automotive Battery Company Limited)	Average Abnormal Return	0.25%	-1.15%	0.25%	1.39%
	Cumulative Abnormal Return	-5.49%	-5.74%	-6.72%	-0.99%

Figure 2. Industrial Sectors 11 Days Analysis

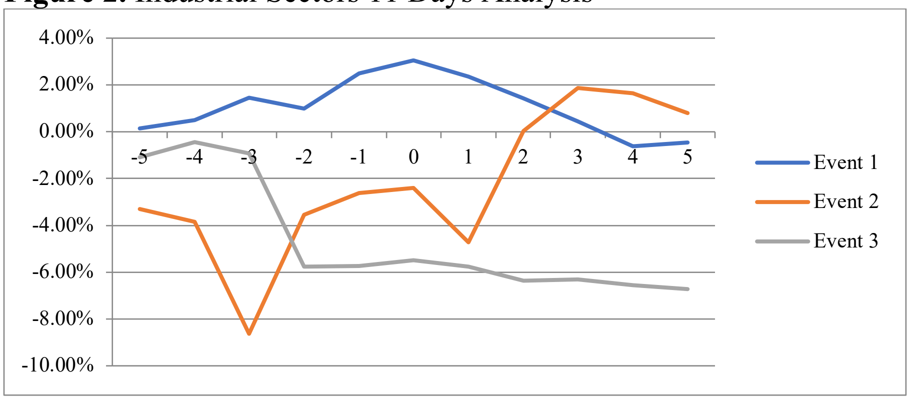


Table 4. Short Term Analysis Results of Industrial Sectors

	Average Abnormal return	Cumulative Abnormal Return	T-Statistic
Industrial sector 91 days results			
E1	-0.09%	-8.12%	-0.679
E2	0.26%	24.02%	1.128
E3	0.45%	41.11%	1.457
Industrial sector 11 days results			
E1	-0.04%	-0.47%	-0.164
E2	0.07%	0.79%	0.078
E3	-0.61%	-6.72%	-1.376

Long Term Analysis

In industrial sector the long term analyses result interprets that the Event 1 Show -35% BHAR after 360 days of announcement of merger deal and, Further for the Event 2 BHAR is 19% after 360 days and highest of this event was 60% after 270 days of announcement. Lastly, the third event show BHAR after 360 days at -49%, and highest of this event was 01% after 90 days of announcement, and the T values of all the events are insignificant in the long run So, it can be interpreted that the industrial sector of Pakistan mostly insignificant results in terms of returns to the shareholders in the long run and does not created value for the shareholders in the long run and rejected the BHAR hypothesis.

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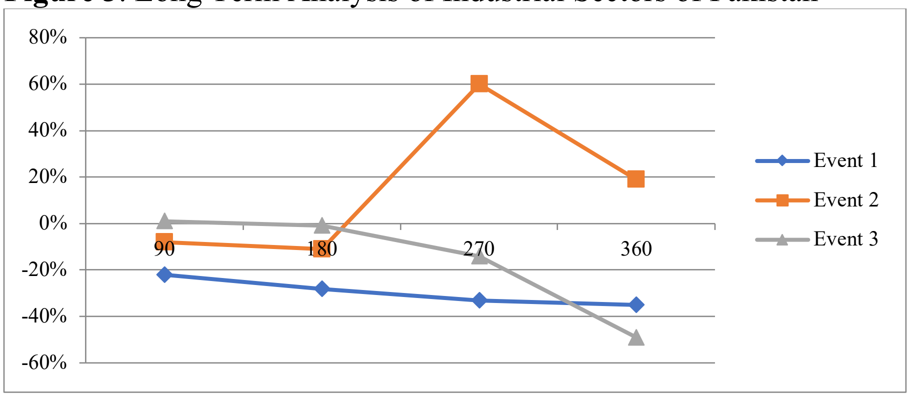
Table 5. Long Term Analysis

S.No	90 days		180 days		270 days		360 days	
	BHAR	T value	BHAR	T value	BHAR	T value	T value	BHAR
Event 1 (Bestway Cement Limited- Pakcem Limited)	-22%	-1.395	-28%	-1.289	-33%	-1.312	-35%	-1.157
Event 2 (Gadoon Textile Mills Limited- Fazal Textile Mills Limited)	-8%	-0.533	-11%	-0.491	60%	1.758	19%	0.476
Event 3 (Exide Pakistan Limited- Automotive Battery Company Limited)	1%	0.042	-1%	-0.023	-14%	-0.305	-49%	-0.954

Figure 3. Long Term Analysis of Industrial Sectors of Pakistan



Accounting Method Analysis

Here the results of Event 3 are positive in terms of ROA and increasing the efficiency of the firms, While the results indicate that Event 1 and 2 have negative ROAs values showing that occurrence of events have decreased efficiency of these firms, the values -4.79and -4.77 for the event 1 and 2 respectively, these results are aligned with the findings of Abbas et al (2014) and contradict with the findings of Abdul Rahman & Ayorinde, Ong et al and Osho (2013; 2011; 2004).

Below table states the Return on Equity (ROE) of the industrial sectors merged companies under study. Results indicate that ROE change for the Event 1 is -8.45 and Event 2 has -5.76 indicating that the post ROE performance of firm has declined while the event 3 has raise of 3.67. These results are consistent with the Abbas, Hunjra, Saeed, Ul Hassan, and Ijaz (2014), Kayani, Javed, Majeed, and Shaukat (2013) and Kemal (2011).

The Net Profit Margin (NPM) shows the net income i.e profit after taxes has been generated from sales. It is said that the companies with higher NPM are the best market players(Kouser & Saba, 2011). The below table shows the effect of NPM before and after occurrence of events on the performance of industrial sectors of country. The results indicate negative change in NPM for the all the events in industrial sectors having values -19.50, -2.42 and -0.22 for the event 1, 2 and 3 respectively. Overall sector shows negative effect on banking sector and results are consistent with the Osho(2004), Abdul Rehman & Ayroinde(2013).

The Earning per Share (EPS) ratio show that how much the company has earned per share during the period. A raise in profit will raise the EPS but if company issues new share during the period it will reduce the EPS (Gyimah & Oscar, 2011). Below table show the EPS for the events related to industrial sector of Pakistan. Results indicate that EPS is positive for Event 3 only while it is negative for event 1 and 2 having values of -0.68 and -13.19 respectively. This negative result is consistent with the result of Abbas, Hunjra, Saeed, Ul Hassan, and Ijaz (2014) and Kemal (2011).

Table 6. Industrial Sectors ROA and ROE

Event	Average pre ROA (%)	Average Post ROA (%)	Change in ROA	T Statistics	Average Pre ROE	Average Post ROE	Change in ROE	T Statistics
Event 1 (Bestway Cement Limited- Pakcem Limited)	15.99	11.21	-4.79	0.099	28.21	19.76	-8.45	0.093
Event 2 (Gadoon Textile Mills Limited- Fazal Textile Mills Limited)	7.35	2.58	-4.77	0.134	13.34	7.58	-5.76	0.236
Event 3 (Exide Pakistan Limited- Automotive Battery Company Limited)	9.67	13.61	3.94	0.007	16.00	19.67	3.67	0.005

Table 7. Industrial Sectors NPM and EPS

Event	Average pre NPM (%)	Average Post NPM (%)	Change in NPM	T Statistics	Average Pre EPS	Average Post EPS	Change in EPS	T Statistics
Event 1 (Bestway Cement Limited- Pakcem Limited)	29.48	9.98	-19.50	0.022	15.66	14.98	-0.68	0.333
Event 2 (Gadoon Textile Mills Limited- Fazal Textile Mills Limited)	4.58	2.16	-2.42	0.190	33.63	20.44	-13.19	0.250
Event 3 (Exide Pakistan Limited- Automotive Battery Company Limited)	3.87	3.64	-0.22	0.178	15.00	29.76	14.76	0.003

Conclusion

The mergers and acquisitions trend in Pakistan started after 1998. After 1998, large number of events occurred in Pakistan every year. This trend of M&As can be seen in the financial, industrial and telecom sector of the Pakistan (Tauseef & Nishat, 2014). Synergy hypothesis state that the firms go for the M&As with an aim to increase growth, reduce costs, acquire assets and expand business in to the new markets. This leads towards increased performance of firms, increase profitability and increased wealth of the shareholders (Martynova & Renneboog, 2006).

The aim of this study was to review the impact of M&As on the financial performance of industrial sector of Pakistan in terms of shareholders' wealth and financial stability of the firms undergone for M&As in this sector. This was done in three ways; first, short term performance was analyzed with the help of an event study method to interpret abnormal returns after the M&As. Secondly, Long term performance was analyzed with the help of BHAR, as per different authors, such events of M&As take a longer time to mature. Thirdly, the financial performance was also analyzed using the accounting method in which Profitability ratios including: ROA, ROE, NPM and EPS were analyzed for three years pre and post-performance.

It can be interpreted that the M&As events in the industrial sector of Pakistan did not create value on the wealth of shareholders in the short-term analysis in two different estimation windows including: 91 days and 11 days. Hakkinen and Hilmola (2005) in their study suggested that outcome of synergetic gain may require more and longer time period to be effective as this gain is dependent highly on the integration process. So to extend the scope of this study, long term analysis was conducted using BHAR technique, in which the returns of firms were analyzed for the 90,

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180, 270 and 360 trading days respectively. The outcome of this technique was similar to the short run study for the industrial sector of Pakistan as the market did not responded to the occurrence of M&As, ultimately did not create value for the shareholders in the long run as well rejecting the synergy theory in the long run.

The results of this study are similar to the studies which also reported negative results in terms of shareholders' wealth in their studies (Adnan & Hossain, 2016; Bashir, Sajid, & Sheikh, 2011; Cummins & Weiss, 2004). Contrary to this, results of this study contradict with the studies which reported positive abnormal returns for the firms in terms of shareholders' wealth (Flugt, 2009; Mahmood, Aamir, Hussain, & Sohail, 2012; Soongswang, 2011). This study adds updated literature of M&As in the industrial sectors of Pakistan, which will add to the knowledge in previous literature and will contribute additional knowledge for the investors, management and policy makers.

Accounting based measures are traditional accepted and relied by researcher for evaluating the performance of Mergers and Acquisitions (Ramaswamy, 1997; Maurizio Zollo & Singh, 2004). This study has analyzed four performance ratios including: Return on Assets (ROA), Return on Equity (ROE), Net Profit Margin (NPM) and Earning per Share (EPS). The results concluded that M&As mostly declined the financial performance of the firms in industrial sector of Pakistan. The performance of industrial sector had declined performance of all the indicators i.e ROA, ROE, NPM and EPS So, it can be concluded that M&As did not improve the performance of the firms in all sectors under study and the results were similar to the findings of the event study methodology.

The outcome of this study rejects the synergy theory in the industrial sector of the country suggesting that the industrial sector of Pakistan should adopt different other strategies for expansion of business rather than opting for merger and acquisition deals. These other strategies may include for a short-term alliance, entering new markets and introducing new services for the existing customers. It suggests that the policymakers should analyze various possible scenarios before going for the deals of M&As. This study aimed the short term and long-term impact of M&As on the wealth of shareholders and aimed to measure financial performance using financial ratios as its indicators. A more enhanced study can be done on the human resource perspective in different firms who have recently undergone for the deals of mergers and acquisitions in Pakistan. Further, the study can be extended to Asian and international perspectives to comparatively analyze the stock market performance of countries, this can be done with the help of stock market performance, accounting method and managerial perspective.

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