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A Study of Motives and Benefits of Merger and Acquisition

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Abstract: *The main aim of every firm is to enhance the profitability of their business and consequently,increase the wealth of the shareholders of the company. There are different approaches of growth through which company can achieve these objectives. Mergers and Acquisitions perform a vital role in corporate finance in enabling firms achieve varied objectives and financial strategies. The Financial sector improves to introduce by the Indian Government during the early 1990s and the key parameters like globalization and post -liberalization of the world economy, Indian Banking has begun to change itself. It is experiencing scenario to change known as 'consolidation' of Indian banking. This study will be conducted for better understanding of merger and acquisition and also motives behind merger and acquisition.*

Key Words: *merger and acquisition, motives.*

1. INTRODUCTION : MERGER AND ACQUISITION

The main aim of every firm is to enhance the profitability of their business and consequently, increase the wealth of the shareholders of the company. There are different approaches of growth through which company can achieve these objectives. These approaches mainly divided into two categories including Internal Growth and External Growth of the firm. The internal growth is also named as Organic Growth and external as Inorganic Growth. The organic growth involves new product development, entering into new markets for the existing products, expanding business by opening new branches in different cities and installing new related projects etc. The inorganic growth can be accomplished through mega structural changes in company such as merger & acquisitions of existing well established company, entering into joint ventures and adopting strategic alliance practices with other companies. There are various ways in which merger and acquisition can be completed. These modes mainly include mergers, amalgamations or consolidations of two or more companies, acquisitions of existing companies, acquisition of asset of any company, leverage buyouts, management buyouts, spin-offs and split-offs etc. Since, last two decades, tremendous growth has been observed in merger and acquisition activities at world level. India is also not the exception of this. This global trend has also been embraced by firms' operational in India at very high scale. This growth can be seen both in terms of increase in number of deals as well as magnitude of merger & acquisition deal value.

2. CONCEPT OF MERGER AND ACQUISITION :

Merger is mainly described as a phenomenon that involves combination of two or more companies into one where firm continuing its business can be one of existing firm or completely a new company formed as consequence of merger activity. Companies involved in merger activity are divided into two categories. Companies which transfer their assets and liabilities to other company are termed as Transferor Company and company in which assets and liabilities are transferred is called Transferee Company. In merger and acquisition deals transferee Company pay consideration to transferor companies in return for their assets and liabilities transferred. This consideration can be paid in any form such as: Issuance of equity shares of the transferee company, Issuance of Debentures in the transferee company, Cash consideration, Mixture of above mentioned modes of payment.

Kinds of Merger and Acquisition :
Horizontal Merger

Horizontal merger is the type of merger in which two or more companies operating at the same level of industrial process are combined together. The acquisition firm and target firm both pertain to the same industry. In other way, it is said to be the merger of two competitive firms.

Vertical Merger

Vertical merger is a type of merger in which firm getting merged together operate in same value chain. Value chain here refers to the firms creating value by providing various facilities in form of product and services to firm operating on hierarchical supply chain system. These firms do not compete with each others. The main goal of such type of mergers are to reduce down the buying cost of materials, to control the distribution and selling expenses of firm and to make difficult for potential competitors to enter into the market.

Conglomerate Merger

Conglomerate merger is the type of merger whereby two or more companies working in different and unrelated industry are merged together. These mergers help companies to diversify their activities and businesses in different product category and industries. It reduces the firm risk of becoming loss making unit to greater extent.

3. Literature Review :

Chatterjee (1986) examined the impact of Acquisitions on Merging and Rival Firms and economic value. The merger data were gathered primarily from the Federal Trade Commission's (FTC) Statistical Report on Mergers and Acquisitions. The study found that collusive synergy is, on average, associated with the highest value. Further, the resources behind financial synergy tend to create more value than the resources behind operational synergy.

Fowler (1989) examined the relationships between strategic acquisition factors and long-term financial performance measures of acquiring firms. The factors of interest include relative size, previous acquisition experience, organizational age, industry commonality, contested versus uncontested acquisitions, and percentage of stock acquired. The findings of the study indicates that, on the average, post-acquisition financial performance improved significantly for organizations that had previous acquisition experience, acquired a higher percentage of a target, or were older. Post-acquisition performance decreased significantly for acquiring firms when target firms contested an acquisition.

Datta et. al (1992) analyzed the empirical literature concerning the influence of various factors on shareholder wealth creation in mergers and acquisitions. Multiple regression approach used in the analysis. Findings indicate that the use of stock financing has a significant impact on the wealth of both the target and bidding firms' shareholders. The study suggested that presence of multiple bidders and the type of acquisition influence the bidders' return, while regulatory changes and tender offers influence the targets' returns

Loughran and Vijh (1997) Investigated that relationship between the post acquisition returns and the mode of acquisition and form of payment. The sample used in the study were 947 acquisitions during 1970-1989. Over the combined pre acquisition and post acquisition period, target share- holders who hold on to the acquirer stock received as payment in stock mergers were not earn significantly positive excess returns. The study concluded that the acquirer's managers were choose stock payment when their stock was overvalued and cash payment when it was undervalued. Apparently, the market did not react efficiently to the likely wealth gains from the business combination or to the news conveyed by the form of payment.

Avkiran (1999) Examined the role of mergers and the benefits to the public. Operating effciencies, employee productivity, profit performance and average relative efficiency were also measured for Australian trading banks from 1986 to 1995. The author suggested to the future researcher in this area to establish a means of measuring the profit function which allows probing of efficiencies on the cost as well as the revenue side of business. The limitation of the study was as deregulation of the banking industry in Australia continues to unfold, competition will force banks to merge with other banks or financial institutions, cut costs, innovate in such areas as service delivery and revenue generation, or even exit the industry if the former strategies are not successfully implemented.

Cybo-Ottone and Murgia (2000) analyzed the stock market valuation of the largest mergers and acquisitions between banks and financial institutions in the European markets from 1988 to 1997. The samples used in the study were 54 M&A in 14 European marketsThe methodology used in the study was event study for measuring abnormal stock market returns, Z-test and Wilcoxon statistics test. The results showed that there was a positive and significant increase in value for the average merger at the time of the deal's announcement. On the contrary also found that M&A with securities firms and concluded with foreign institutions did not gain a positive market's expectation. The study also suggested that it gives different results from the US banking industry dur to different structure and regulation of EU banking markets

Antony Akhil (2011) in an analysis "Post-merger profitability of selected banks in India" examined the impact of the banks merged in India from 1999 to 2011. Between 1999 and 2011, around 18 M&A took place in the Indian banking sector The study findings indicate that there is a significant difference in the profitability ratios, like (growth of total assets ratio, growth of net profit ratio, return on assets ratio, return on equity ratio, and net interest margin ratio) of banks in the post-merger scenario.

Dutta and Dawn (2012) in a paper "Merger and acquisitions in Indian banks after liberalisation: An analysis" investigates the performance of merged banks in terms of its growth of total assets, profits, revenue, deposits, and number of employees. The performance of merged banks was compared taking four years of prior-merger and four years of post-merger. The study findings indicate that the post-merger periods were successful and saw a significant increase in total assets, profits, revenue, deposits, and in the number of employees of the acquiring firms of the banking industry in India.

Leepsa and Mishra (2012) in their study analysed the financial performance of manufacturing sector companies in India in terms of profitability, liquidity and solvency. It analyzes three year pre and post performance of manufacturing companies. The data was analysed with the help of statistical tools paired sample t-test, descriptive statistics. It was concluded that the profitability position of the companies has increased in terms of return on capital employed and decreased in terms of return on net worth and the financial performance of the company's improved after merger in terms of current ratio, quick ratio, return on capital employed, interest coverage ratio.

Sai and Sultana (2013) evaluated the performance of the selected two banks based on the financial ratios from the perspective of pre and post - merger. To analyse the impact of merger paired t-test was applied to the various financial ratios for before and after merger data. Based on the analysis of Indian overseas bank data, it can be concluded that Net Profit Margin, Operating Profit Margin, Return on Capital Employed, Return on Equity and Debt- Equity Ratio there was significant difference but no significant difference with respect to Gross profit margin. Based on the analysis of HDFC bank data it can be concluded that Net profit margin, Operating profit margin, Return on capital employed, Return on equity and Debt- Equity ratio there was no significant difference in these ratios before after mergers compare there was significant difference with respect to Gross profit margin.

4. Objective of the study :

The main objective of the study is to overview of merger and acquisition and motives behind mergers and acquisition.

5. MOTIVES OF MERGERS AND ACQUISITIONS:

This section of the study underlines the prime motives that induce companies for merger and acquisitions with other companies. Following are the major motives that promote merger and acquisition activities: • Strategic Motives • Organizational Motives • Financial Motives

Following are the main strategic motives that company wants to achieve through merger and acquisition activity:

Strategic Motives

➢ **Growth and Diversification** Growth and diversification are regarded as the core objectives of any business organization. For a company which aims to expand its business or enter into new market, acquisition of well-established firm provides various benefits such as lower competition, less risk and low cost etc. The merger and acquisition approach is considered the fastest and easiest way of growth and diversification of any business organization.

➢ **Economies of Scale** In case of combination of two or more companies, synergy effect can be observed in form of increased profit in proportionate to the cost occurred in this activity. This is possible because large scale production provides various economies of scale to the company. These economies of scale are mainly occurs due to optimum utilization of production capacities of both the company, dispersion of distribution channels to far geographical markets, transfer of knowledge in form of sharing of research and development facilities, easy data processing systems etc.

➢ **Synergy** Synergy effect of merger and acquisition is also a major factor behind merger and acquisition promotion. The word synergy is defined as "the integration of two or more organizations or substances, to produce a combined effect greater than their separate effect". Synergy is simply said to be taken place when value of merged company is greater than total of value of individual companies before merger. Symbolically it can be defined as: **V (XY) > V (X) + V (Y)** Where V (XY) = Value of the merged entity V(X) = Independent value of company A V(Y) = Independent value of company B

➢ **Restraining Unhealthy Competition** Merger and acquisitions approach may also help companies to avoid unhealthy competition in a condition where many firms aim to target limited market.

➢ **New Market Entry** Gaining the market share of competitor in a new market involves lot of efforts and cost on advertisement and promotional activities for the company aiming to target new markets. Therefore, merger and acquisition is a cost effective and easy way to establish the company in new market with minimum efforts. Thus, these are the major strategic motives of merger and acquisition.

Organizational Motives :

➢ **Empire Building** The giant corporate houses have surplus funds with them that motivate the top management of the company to grab new opportunities through merger and acquisition activities. These corporate houses build a very large scale enterprise through merger and acquisition. It will also persuade entrepreneurs and senior managers to utilize their skills to operate such big companies.

➢ **Retention of Managerial Talent** The success of any business enterprise largely entrusted to the human resource talent with them. Managers of the company are the bloodline of any company. Growth of company can be assured by retaining and hiring talented manager in the company. Merger and acquisition helps companies in attracting new talent in their company. **Financial Motives**

➢ **Tax planning** Merger and acquisition is used as the strategy for availing tax benefit by acquiring sick unit. Under section 72 A of Income Tax Act, if any profound company acquires a sick unit through mode of merger, accumulated losses occurred in that sick unit can be write off against the profit of healthy companies. This way company can save their tax up to a limit and this can be used for revival of sick unit.

➢ **Higher Debt Capacity** A large company can borrow large amount of funds from market very easily in comparison to small firms. Further, raising funds from market in bulk amount can also be cost effective in term of lower interest rate charged by the investor. The merged entity enjoys a good reputation in the market due to stability of their returns. This increases their debt raising capacity. A high debt company also gets the tax shield benefit of using debt capital in capital structure of the company. Thus, consequently it increases the earning of shareholders of company and value of the firm.

➢ **Reduction in Flotation Cost** Flotation cost of new shares can also be saved by issuing greater number of shares in the market. Merged entity can afford to issue shares and debentures in big lot sizes. This saves the flotation cost of the company.

➢ **Lower Rate of Borrowings** The merger and acquisitions creates large size business firms. This large size of firm bring stability in the earning of the company which can lead to greater earning power and stability lead to reduction in the cost of borrowing. Therefore, merger and acquisition also benefit companies by reducing their cost of borrowing. Therefore, these are the major motives that prompt companies to opt for merger and acquisition strategy to expand their business.

6. Conclusion :

Merger and acquisition is widely recognized tool used for execute corporate strategies and aimed at maximizing shareholder value. The combined talent resources of the both companies help in competitive advantage. Merger and acquisition also helps in financial help in the transaction. The *mergers acquisition* activity has also led to the internationalization of business operations.

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