Investigating the Operating Performance of Merged Companies in Textile Sector of Pakistan

Dr. Abid Usman (Corresponding Author)
Assistant Professor
Sarhad University of Science & Information Technology
Peshawar, Pakistan
E-mail: abidusmanktk@yahoo.com & dpgs@suit.edu.pk

Muhammad Kashif Khan
Lecturer
Preston University, Islamabad
Pakistan
E-mail: kashifdurrani81@hotmail.com

Abdul Wajid
Economist
Irrigation Department Khyber Pakhtunkhwa
Pakistan
E-mail: awajid2006@yahoo.com

Muhammad Imran Malik
Ph.D. Scholar
FUIEMS, Foundation University Islamabad
Pakistan
E-mail: im4imranmalik@yahoo.com

ABSTRACT

This study analyzes the operating & financial performance of merged companies in the textile sector of Pakistan during the period 2001 to 2005. For analysis three years pre- and three years post-merger financial statements of the sampled companies are used. The hypotheses are tested through paired sample t-test. The calculated results reveal insignificant decrease in the operating performance of merged firms during the post-merger three years period. Moreover, the projected performance is calculated through ordinary least square method. The results show insignificant increase during the post-merger three years period with respect to pre-merger three years performance. The findings of projected scenario demonstrate that these companies could have performed insignificantly well in comparison to their actual performance after mergers.

Keywords: Mergers, Operating performance, projected performance, textile sector

INTRODUCTION

The organizations create value through growth. The growth may be considered the most important factor for the survival of organizations. This process may be achieved by internal as well as external means. Growth through internal means can be achieved by expanding the existing activities (investing on the current assets or on fixed assets) either by setting its own up-scale units in the market or producing new products; and firms can also achieve growth through external means namely mergers and acquisition, amalgamation, takeover and joint ventures.
There are a number of reasons behind mergers; like to overcome the problem of slow growth; to achieve diversification; to gain economies of scale; to be part of globalization; to utilize underutilized resources; to save taxes. Shriftees and Stevens (1979) argued that enhancement of market power to acquire the economies of scale results in diversification; minimization of tax and prevention of bankruptcy.

Some researchers expressed that merging firms generate value for the shareholders and some researchers are of the view that there is no such improvement. The main research questions answered in this study includes, whether there is an improvement in the operating performance of the merged textile companies in Pakistan? Moreover, has the borrowing power of the textile merged companies increased during the post merger period?

1. OBJECTIVE

The objective of this study is to compare the post- and pre-merger operating performance of merged firms in the textile sector of Pakistan to see if there is any change due to the merger event.

2. LITERATURE REVIEW

Azhagaiah and Kumar (2011) find that merging firms with well reputed and good management gained financial benefits and improved performance in short term. Laabs and Schiereck (2010) analyzed the long term performance of acquirer by considering the sample of 230 takeovers for the period of 1981 to 2007 in the automotive supply industry. They find that acquirers gain short term return but their return diminishes over a long term period from 20% to 16%.

Decline in the operating performance in terms of profitability of the merged firms was observed by few researchers. Mantravadi & Reddy (2008) find that the operating performance of non financial institution, textile, pharmaceuticals and electrical industry yield marginal negative impact on the overall operating performance of the mergers and incurring losses on the chemical and agri-products based sector.

Ramakrishna (2008) finds that merged firms performed well during their post-merger period on average with respect to the pre-merger period. Kruse, Park, Park and Suzuki (2007) finds that the operating performance of 69 non financial merged firms improves during their five years post merger period as compared to their five years pre-merger period. Vanitha and Selvam (2007) finds significant increase in the operating performance for 06 merged firms; whereas 17 merged firms show insignificant increase in their operating profits. Demirbag and Tatoglu (2007) examines the post mergers performance by considering three factors of performance i-e Research Productivity, Return on Investment and Net Profit Margin. The research productivity of firms during their post merger years declines with respect to pre merger years and the competitor’s firms in the market. Whereas the profit margin improves with respect to the pre merger years but remained at constant against their rivals. Kumar and Rajib (2007) generate the empirical results of mergers. Their results on profitability reveal that the merged firms have lower profitability than the firms not indulged in mergers and acquisitions.

In the study by Pazarskis, Vogiatzology, Christodoulou and Drogalas (2006) of the 50 Greek firms, it is found that the operating performance decreases after mergers. Ooghe, Laere and Larghe (2006) statistically analyzed the post-acquisition financial performance of 143 Belgian acquiring firms during 1992-1994. The researchers find that acquiring firms’ financial performance does not seem to improve in the period following the acquisition. Rahman and Limmack (2004) study the operating performance of 94 Malaysian companies from the population of 113 companies merged during the period from 1988 to 1992. They found that the operating cash flow of merged companies significantly improves after acquisition. Müslûmov (2002) analyzed the operating cash flow performance of 56 merged US companies from 1992 to 1997 and finds significantly improved performance. The post merger performance was not only based on market gains but also improved operating

3. METHODOLOGY

In this study the merged textile companies of Pakistan during the period from 2001 to 2005 are identified from the official website of the Karachi Stock Exchange. As a precondition both the merged companies should be public limited companies registered at Karachi Stock Exchange. Moreover three years prior and three years after merger financial data must be available for analysis. Initially, 07 merger events were observed in the textile sector. However, 02 merger events were dropped due to non availability of the required data. The final sample comprises of 05 merger events (05 acquirers and 09 acquired companies).

The financial data of merged firms is analyzed by adopting two procedures. Firstly, for pre-merger period, each variable is calculated for each of the three years (-3,-2,-1) separately for both the acquirers’ and the acquirees’ firms in the sample. Similarly, the testable variables are then calculated for the acquiring firms only for three years post merger period (+1, +2, +3). A combined mean for three years pre and combined mean for three years post-merger period is then calculated. The difference between the mean performance measure of the pre- and post-merger years is then worked out. To verify the results and significant differences in the performances during the pre and post merger periods the researcher uses Paired sample t-test.

Secondly, each variable is projected for three years post-merger period using the ordinary least square (OLS) method by assuming that the sampled merged firms did not merge; to see how the performance of merged firms would have been had they not merged. The paired sample t-test is used to get any significant differences between the mean of projected years with the mean of pre-merger years.

3.1 Performance variables and research methods:

1. Various variables like return on assets (ROA), return on equity (ROE), Net Profit Margin, Equity to total capitalization, and Debt to total capitalization for merged firms during their pre and post merger periods are calculated.
2. The acquirers’ and acquirees’ variables are projected for three years post merger period considering them as separate entities.
3. The difference between combined means of variables for post and pre-merger three years is calculated.
4. Paired sample t-test is used to find any significant difference between the two periods.
5. The difference between the projected combined means of variables and the pre-merger combined means is tested through paired sample t-test for any significant change.

4. HYPOTHESIS

The following null hypotheses are presented for test:
1. H0: There is no significant difference in the post-merger operating performance of the merged firms relative to the pre-merger operating performance.
2. H0: There is no significant difference in the projected post-merger operating performance of the merged firms relative to the pre-merger operating performance.

5. FINDINGS

The difference between the pre merger combined mean of three years (-3,-2,-1) and post merger three years (+1,+2,+3) combined mean for the 05 merger events (05 acquirers and 07 acquirees) sampled companies during the period 2001 to 2005 is given in table no. 1.1.
The calculated results of combined mean of pre-merger three years and combined mean of post-merger three years show insignificant decrease. The combined mean of ROA during post-merger is 0.0744 and during the pre-merger it is 0.0928 this shows insignificant decrease by -19.81%. While the combined mean of ROE during post-merger year is 0.16466 and pre-merger year is 0.2134, which is an insignificant decrease of -22.86%. The combined mean of net profit margin insignificantly increase by 20.53%. Whereas the combined mean of NPM of post-merger years is 0.0986 and the combined mean of NPM of pre-merger years is 0.0818. The combined mean of equity to total capitalization during post-merger period is 0.674 and combined mean during pre-merger period is 0.0818 which is an insignificant decrease of 4.51%. The combined mean of debt to total capitalization during post-merger years is 0.902 and 0.3975 during pre-merger years that indicates insignificant increase of 126.88%. Based on the above results the null hypothesis number 01 is accepted.

**CONCLUSION AND DISCUSSION**

The financial indicators reveal that mergers in the textile sector of Pakistan during 2001-2005 did not achieve any significant improvement during their three years post-merger period. It gives an impression that profit is not effectively generated through the available combined resources. The combined mean of three years projected post merger results reveal that the merged textile companies could have performed insignificantly well, had they not undergone merger event, as far their operating performance is concerned in comparison to their post merger actual operating performance. The actual post merger profitability variables (ROA, ROE) show decreasing trend during the post-merger three years period except for NPM that records insignificant increase. Whereas, the three profitability ratios (ROA, ROE, NPM) for projected three years post merger period records insignificant increasing trend over the pre merger three years results. The leverage ratios (Equity to total capitalization and Debt to total capitalization) reveal that the merged companies’ owners’ equity has not been significantly used to finance their needs. Rather, the companies relied more on debt financing after mergers that resulted in the increase of fixed costs and reduced profitability.

**RECOMMENDATIONS**

On the basis of analysis of the secondary data, it is recommended that

- The management of the merging companies must have to concentrate on the available resources to achieve the economies of scale by producing more units at lower cost.
- The operating and financial performance of merged companies in other sectors may also be evaluated.
- The impact of financial performance on shareholders’ wealth needs to be checked through event study methodology.
- The analysis period may be extended from three years to five years during pre and post merger period so that long term performance can be assessed.
REFERENCES


Table No. 1.1 Combined mean differences of the pre-merger three years and post-merger three years.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Pre-merger Mean</th>
<th>Post-Merger Mean</th>
<th>Difference</th>
<th>Difference in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>0.0928</td>
<td>0.0744</td>
<td>-0.01839</td>
<td>-19.81</td>
</tr>
<tr>
<td>ROE</td>
<td>0.2134</td>
<td>0.16466</td>
<td>-0.0488</td>
<td>-22.86</td>
</tr>
<tr>
<td>NPM</td>
<td>0.0818</td>
<td>0.0986</td>
<td>0.0168</td>
<td>20.53</td>
</tr>
<tr>
<td>Equity to Total Capitalization</td>
<td>0.7031</td>
<td>0.674</td>
<td>-0.0291</td>
<td>-4.15</td>
</tr>
<tr>
<td>Debt to Total Capitalization</td>
<td>0.3975</td>
<td>0.902</td>
<td>0.5044</td>
<td>126.88</td>
</tr>
</tbody>
</table>

Source: Analysis of Secondary data

- P < 0.10. ** P < 0.05
Table No. 1.2 Combined mean differences of the projected three years and combined mean differences of pre-merger three years.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Pre-merger Combined Mean</th>
<th>Projected Combined Mean</th>
<th>Difference</th>
<th>Difference in % age</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>0.0928</td>
<td>0.1238</td>
<td>0.031</td>
<td>33.40</td>
</tr>
<tr>
<td>ROE</td>
<td>0.2134</td>
<td>0.2403</td>
<td>0.0269</td>
<td>12.60</td>
</tr>
<tr>
<td>NPM</td>
<td>0.0818</td>
<td>0.1346</td>
<td>0.0528</td>
<td>64.54</td>
</tr>
<tr>
<td>Equity to Total Capitalization</td>
<td>0.7031</td>
<td>0.6366</td>
<td>-0.0665</td>
<td>-9.45</td>
</tr>
<tr>
<td>Debt to Total Capitalization</td>
<td>0.3975</td>
<td>1.0752</td>
<td>0.6777</td>
<td>170.49</td>
</tr>
</tbody>
</table>

Source: Analysis of Secondary data

* P < 0.10.  ** P < 0.05