MERGER AND ACQUISITION AND FIRM'S PROFITABILITY: A COMPARATIVE STUDY OF PRE AND POST MERGER PROFITABILITY OF FIRMS IN PAKISTANI TEXTILE SECTOR

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ABSTRACT

This study has been carried out to evaluate the impact of merger on firm's profitability in Pakistani textile sector. Literature suggests inconclusive and limited research in this regard. To understand the impact of merger on firm's profitability three years pre and post-merger profitability measures (ROA, ROE, NPM) have been considered and mean values and difference of mean values have been compared for these profitability measures. For this purpose paired sample t-test has been applied. A total fourteen mergers taken place between 1995 and 2010 have been taken into account. The findings of study are in alignment with the previous research i.e. inconclusive towards this end. However, in majority of cases the impact of merger on firm's profitability is negative but insignificant. This negative impact may be due to the fact that many of the mergers took place with the firms which were declared as sick units and hence negatively affected the profitability. This suggests more research efforts to enrich our understanding that why do companies merge if the merger is not this much significant to firm's profitability.

INTRODUCTION

Merger and acquisition are two exchangeable terms and refer to the combination of two or more firms to achieve comparatively better operating and financial results (Alao, 2010, DePamphilis, 2010). However, theoretically the two terms are defined differently. Merger is a process where two or more firms combine and emerge as a new firm, while acquisition is a process in which one company takes over the other company and run its businesses (Tanriverdi, 2013). In this paper, we use term 'merger' for both merger and acquisition. Merger is considered as significant to firm's profitability (Tanriverdi, 2013). Research has shown varying effects of merger on firm's profitability. Some researchers (e.g. Erel, Liao, & Weisbach, 2012) are of the view that merger is significant to increase firm's profitability, while others (e.g. Sharma & Ho, 2002; Tanriverdi & Uysal, 2015); Tambi, 2005) talked about negative impact of merger of firm's profitability. Still, there are others (e.g. Mantravadi & Reddy, 2008; Asimakopoulos & Athanasoglou, 2013) who are indifferent in this regard.

Some, also, consider merger as irrelevant to firm's profitability (Ismail, Abdou & Annis, 2011). All this suggests that the research is not conclusive with respect to the effect of merger on firm's profitability and more research studies are needed to this end. Hence, the main aim of this study is to analyse the impact[s] of merger on firm's profitability by comparing the pre and post-merger profitability of firms in textile sector. This is to mention that there is limited research in the context of Pakistani Textile sector (Ahmed & Ahmed 2014). This study is expanded over entire textile sector and takes into account all merger transactions happened during 1995 to 2010. This is hoped that this study will contribute to the on-going discussion of effects of merger on firms' profitability and hence will further enrich our understandings to this end. The study may also be helpful towards policy formulation in this regard.

LITERATURE REVIEW

In recent times, merger has been observed as worldwide economic phenomenon and on average four thousand mergers are taking place every year. Generally, firms involve in merger transactions to achieve market power, economies of scale, growth and expansion and competitive advantage (Buono & Bowditch, 2003). But, the most important reason of merger is to achieve synergy (Ramakrishnan, 2008). Synergy refers to firm's value maximization (Mahesh & Prasad, 2012). Synergy can be achieved through reduced fixed cost and increased profitability (Tambi, 2005). Merger is considered as having greater impact on firm's profitability (Tanriverdi, 2013; Mantravadi & Reddy, 2008). Merger improves not only short term but also long term profitability of the firms (Ramaswamy & Waegelein, 2003). Ramaswamy & Waegelein, (2003) used regression analysis to study the impact of merger on profitability of 162 companies for the period 1975 to 1999. They found that post-merger profitability of these companies increased by 12.7 percent. Another similar study showed the positive impact of merger on firm's profitability and cash flow (Tambi, 2005). There are evidences that merge is not only significant to firm's profitability but also increases firm's overall financial efficiency (Mantravadi & Reddy, 2008).

On the other hand there are researchers who claimed negative impact of merger on firm's profitability (Altiol & Yilmaz, 2001). Literature cited that merger is not the source of synergy and has negative effect on firm's profitability. This is due to the reason that merger causes significant cut in firm's productivity and sales growth rate (Tanriverdi & Uysal, 2015). Merger not only negatively affect short term profitability but also long term profitability (Cabanda & Pajara-Pascaud, 2007). Mantravadi and Reddy (2008) studied the impact of merger on firms' profitability of 118 companies from financial and manufacturing sectors for the period 1999 to 2010. They used different measures of profitability (e.g. operating profit margin, net profit margin, gross profit margin etc.) and concluded that other than the financial sector companies; merger has negative effect on profitability of manufacturing sector companies. Similar results were reported by Selcuk and Yilmaz (2001) in study of 62 companies for the period from 2003 to 2007. One of the recent studies of 11 companies listed in Bombay Stock Exchange In a recent study showed negative impact of merger on different measures of firm's profitability (Sharma, 2013).

There are also evidences of negative impact of merger on firm's profitability in Pakistani textile firms. A comparative study of pre and post-merger for the period 2001 to 2005 was carried out to determine the impact of merger on firm's profitability by using different measures of profitability including return on assets, return on equity, net profit margin, and debt to total capital and equity to total capital. Three years pre and post-merger data was analyzed by using paired sample t-test. The result showed significant negative decrease in terms of different measures of firm's profitability. As stated earlier that research is not conclusive with respect to effect of merger on firm's profitability. There are studies which argue that merger is insignificant to firm's profitability. One study showed that merger did not significantly affect the profitability of the firm (Ismail et al, 2010). Pawaskar (2001) studies 36 companies for the period 1992 to 1995 and concluded that merger has no significant impact in terms of increasing firms' profitability.

Similar results were also reported by Kumar (2009) and Pazarskis et al. (2006). In one of the recent studies (Ahmed & Ahmed, 2014) of 12 companies in Pakistani manufacturing sector for the period 2000 to 2009 by considering three year pre and three year post merger data and using paired t-test, it was concluded that there is insignificant increase in profitability of merged firms.

On the basis of the above sited literature following research hypotheses are proposed.

- HO: Merger has no significance effect on the profitability of textile sector in Pakistan. ($\mu_a = \mu_b$)
  H1: Merger has significance effect on the profitability of textile sector Pakistan ($\mu_a \neq \mu_b$ i.e. .$\mu_a < \mu_b$ or $\mu_a > \mu_b$)
- HO: Merger has no significance effect on the Return on Assets (ROA) of textile sector in Pakistan ($\mu_{aROA} = \mu_{bROA}$)
  H1: Merger has significance effect on the Return on Assets (ROA) of textile sector in Pakistan ($\mu_{aROA} \neq \mu_{bROA}$ i.e. $\mu_{aROA} < \mu_{bROA}$ or $\mu_{aROA} > \mu_{bROA}$)
- HO: Merger has no significance effect on the Return on Equity (ROE) of textile sector in Pakistan ($\mu_{aROE} = \mu_{bROE}$)
  H1: Merger has significance effect on the Return on Equity (ROE) of textile sector in Pakistan (μ_{aROE}) $\neq$ μ_{bROE}) or $\mu_{aROE} < \mu_{bROE}$) or $\mu_{aROE} > \mu_{bROE}$)

- HO: Merger has no significance effect on the Net Profit Margin (NPM) of textile sector in Pakistan ($\mu_{aNPM} = \mu_{bNPM}$)
  H1: Merger has significance effect on the Net Profit Margin (NPM) of textile sector in Pakistan ($\mu_{aNPM}) \neq \mu_{bNPM}$) or ($\mu_{aNPM}) < \mu_{bNPM}$) or $\mu_{aNPM}) > \mu_{bNPM}$)
  Where µ is mean value of different measures of profitability (ROA, ROE, NPM). $\mu_{a\ is}$ pre-merger mean values and μ_b is post-merger mean value.

The Research Question

This study is intended to answer following research questions

The Main Question

What is the effect of merger on firms' profitability in Pakistani textile sector?

The Sub Questions

- What is the effect of merger on return on assets of Pakistani textile firms?
- What is the effect of merger on return on equity of Pakistani textile firms?
- What is the effect of merger on net profit margin of Pakistani textile firms?

THE RESEARCH DESIGN

This is a longitudinal quantitative study, which uses paired sample t-test as proposed by previous studies in this context (Ahmad & Ahmad; 2014, Tanriverdi, 2013 and Sharma , 2013). The data was taken from the audited annual reports. For the purpose of comparison, three years' pre and three years' post-merger data of merged firms were considered. This sample period is chosen on the basis of availability of both pre and post-merger required data of the firm. Three years is sufficient time for merged firms to release potential gains (Sharma & Ho, 2002). All the mergers in textile sector taken place between, 1995 to 2010 were considered as reported by Karachi Stock Exchange.

There are five basic methods (approaches) which are used to determine the impact of merger on firms' profitability. These include event study method, accounting based methods, managers' subjective assessment method, experts' informants' assessment method and divesture (Haleblian & Finkelstein, 1999). However, many of the research studies more rely on event study and accounting based methods (Cording, 2010). The accounting based method is valid to compare the pre and post-merger financial performance of the firms and hence to determine the impact of merger on firms' profitability (Wang & Moini, 2012).

For the purpose of analysis, the year of merger is excluded because different costs incurred on merger can affect profitability in that year (Healy et al., 1992; Pazarskis et al., 2006). Combined means (μ) of pre and post-merger three years were calculated for all three measures of profitability (ROA, ROE, NPM) and indicated as μ_a and μ_b for pre and post-merger period respectively. Pre and post-merger means were compared to know the impact of merger on firms' profitability. Also the difference between pre and post-merger means were calculated to know if the impact is positive or negative. 'P' value was calculated to see the level of significance of difference of means. .All the data was analyzed with 95% confidence interval.

THE FINDINGS OF STUDY

Following tables show the relevant findings and results of this study.

Merger and ROA

	Before (ROA)				After (ROA)				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
Umer Fabrics	-0.00439	2	2.919986	0.037613	0.091034	2	2.919986	0.037613	-0.095484
Nishat Mills	0.050601	2	0.045587	0.967782	0.049557	2	0.045587	0.967782	0.001046
Textile-Overall	0.2842	13	0.21841	0.830499	0.23142	13	0.21841	0.830499	0.052777

For Umer Fabrics, the above table shows that $\mu_{a\ (ROA)}$ and $\mu_{b\ (ROA)}$ are -0.00439 and 0.09103 respectively, while mean difference -0.095425484. This shows increase in profitability after merger. The results are significant because P value is lesser than 0.05. For Nishat Fabrics, the above table shows that $\mu_{a\ (ROA)}$ and $\mu_{b\ (ROA)}$ are 0.050601 and 0.049557 respectively, while mean difference 0.001043546. This shows decrease in profitability after merger. The results are statistically insignificant because P value is higher than 0.05. For textile sector as a whole, the above table shows that $\mu_{a\ (ROA)}$ and $\mu_{b(ROA)}$ are 0.2842 and 0.23142 respectively, while mean difference 0.052777. This shows decrease in profitability after merger. The results are statistically insignificant because P value is higher than 0.05 (appendix I for other results).

Merger and ROE

Before (ROE)					After (ROE)				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
Umer Fabrics	-0.003416	2	-3.54796	0.071075	0.221328	2	-3.54796	0.071075	-0.2554588
Nishat Mills	0.050601	2	0.045587	0.967782	0.049557	2	0.045587	0.967782	0.0010546
Textile-Overall	0.952921	13	1.196663	0.252806	0.072034	13	1.196663	0.252806	0.880887

For Umer Fabrics, the above table shows that $\mu_{a\ (ROE)}$ and $\mu_{b(ROE)}$ are -0.003416 and 0.221328 respectively, while mean difference -0.255489588. This shows increase in profitability after merger. The results are statistically insignificant because $_P$ value is higher than 0.05. For Nishat Mills, the above table shows that $\mu_{a\ (ROE)}$ and $\mu_{b(ROE)}$ are 0.050601and 0.049557respectively, while mean difference 0.001043546. This shows decrease in profitability after merger. The results are statistically insignificant because $_P$ value is higher than 0.05. For textile sector as a whole, the above table shows that $\mu_{a\ (ROE)}$ and $\mu_{b\ (ROE)}$ are 0.952921 and 0.072034 respectively, while mean difference 0.880887. This shows decrease in profitability after merger. The results are statistically insignificant because $_P$ value is higher than 0.05 (appendix I for other results).

Merger and NPM

Before (NPM)					After (NPM)				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
Umer Fabrics	-0.00316	2	-3.69526	0.06606	0.053174	2	-3.69526	0.06606	-0.0563736
Nishat Mills.	0.036746	2	6.159157	0.025362	-0.06933	2	6.159157	0.025362	0.0113554
Textile-Overall	0.15655	13	1.770933	0.538362	0.052829	13	1.770933	0.538362	0.103728

For Umer Fabrics, the above table shows that $\mu_{a(NPM)}$ and $\mu_{b(NPM)}$ are -0.00316 and 0.053174 respectively, while mean difference -0.056337736. This shows increase in profitability after merger. The results are statistically insignificant because $_P$ value is higher than 0.05. For Nishat Mills, the above table shows that $\mu_{a(NPM)}$ and $\mu_{b(NPM)}$ are 0.036746 and -0.06933 respectively, while mean difference 0.011383554. This shows decrease in profitability after merger. The results are statistically significant because $_P$ value is lesser than 0.05. For textile sector as a whole, the above table shows that $\mu_{a(NPM)}$ and $\mu_{b(NPM)}$ are 0.15655 and 0.052829 respectively, while mean difference 0.103728. This shows decrease in profitability after merger. The results are statistically insignificant because $_P$ value is higher than 0.05(appendix I for other results)

DISCUSSION AND CONCLUSION

It is evident that the results are not conclusive with respect to the overall impact of merger on firms' profitability as different measures of profitability show different results with different levels of significance. In case of ROA, out of 14 merged firm, two firms show significant positive results; two show significant negative results; three firms show insignificant positive results; and rest of the seven firms show insignificant negative results. In majority of cases, the results are insignificance. For ROE, two firms show insignificant positive results; one firm shows significant negative result, and eleven firms show insignificant negative results. Majority of the results are insignificant. In case of NPM, seven results are insignificant negative; two are significant negative, and five are insignificant negative. The overall results for all the firms are inconclusive.

The overall results (appendix II) show that in majority of cases merger has insignificant negative impact of firms' profitability. These results are in alignment with previous study of Pazarskis, Vogiatzogloy, Christodoulou and Drogalas, (2006). There may be different reasons as why merger is not significant to firms' profitability. For example, one of the possible reason could be related to management issues because it is somehow difficult to manage effectively the bigger firms as compared to smaller firms, which has negative effects in terms of firms' profitability. The other important reason may be the operational status of the firms at the time of merger. Many of the merger/acquisition took place with the firms which were declared as 'sick' units. These units were taken over (through merger or acquisition) for the purpose of rehabilitation. Hence, these units could have caused decrease in the profitability for the merged firms.

Appendix: I Mean Values of ROA, ROE, and NPM.

Shahzad Textile Mills Limited (2010)									
Before					After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	0.1228	2	-1.08994	0.389558	2.455139	2	-1.08994	0.389558	-2.332339015
ROE	0.2906	2	0.482819	0.676906	0.141218	2	0.482819	0.676906	0.149382236
NPM	-0.7061	2	-0.82744	0.495001	0.044158	2	-0.82744	0.495001	-0.75025825

Colony Textile Mills Limited (2006)									
Before					After				
	Mean	df	t Stat	P value	Mean	Df	t Stat	P value	Mean Diff
ROA	0.022	2	0.093561	0.933987	0.0191	2	0.093561	0.933987	0.0029
ROE	0.085	2	0.352418	0.758198	0.041967	2	0.352418	0.758198	0.0430333
NPM	0.027	2	-3.3448	0.078944	0.066933	2	-3.3448	0.078944	-0.0399333

Nishat (Chunian) Ltd. & Nishat Mills Ltd. (2005)									
Before					After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	0.153567	2	11.40918	0.007595	0.018	2	11.40918	0.007595	0.1355667
ROE	0.085	2	0.352418	0.758198	0.041967	2	0.352418	0.758198	0.0430333
NPM	0.072333	2	-0.89608	0.464772	0.289	2	-0.89608	0.464772	-0.2166667

Dawood Lawrencepur Limited (2004)									
	Before				After				
	Mean	df	t Stat	P value	Mean	Df	t Stat	P value	Mean Diff
ROA	0.087	2	1.497474	0.272971	-0.002	2	1.497474	0.272971	0.089
ROE	10.36421	2	3.818983	0.062233	-0.02367	2	3.818983	0.062233	10.3878777
NPM	0.132667	2	0.782262	0.515971	-0.01233	2	0.782262	0.515971	-0.38330483

Khinoor Weaving Mills Limited. (2004)									
	Before				After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	0.102333	2	2.596632	0.121802	-0.00749	2	2.596632	0.121802	0.109821071
ROE	0.237396	2	2.43293	0.135449	-0.03578	2	2.43293	0.135449	0.273174103
NPM	0.084667	2	2.437031	0.135082	-0.01657	2	2.437031	0.135082	0.101239891

Legler - Nafees Denim Mills Limited (2003)									
	Before				After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	2.533333	2	2.439318	0.134878	0.313	2	2.439318	0.134878	2.2203333
ROE	0.184126	2	0.18402	0.870966	0.170667	2	0.18402	0.870966	0.0139127
NPM	0.034667	2	-1.61917	0.246833	0.107333	2	-1.61917	0.246833	-0.0726667

Nagina Cotton Mills Limited (2002)									
	Before				After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	0.343833	2	1.570303	0.256927	0.043525	2	1.570303	0.256927	0.3003099
ROE	1.214067	2	1.33786	0.312776	0.090186	2	1.33786	0.312776	1.123017
NPM	0.135667	2	2.203094	0.158464	0.03843	2	2.203094	0.158464	0.0972604
Ibrahim Fibres (2002)									
	Before				After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	0.107667	2	6.105657	0.025791	0.042978	2	6.105657	0.025791	0.0646809
ROE	0.181392	2	5.192942	0.03514	0.086066	2	5.192942	0.03514	0.0953397
NPM	0.156	2	10.18521	0.009502	0.041274	2	10.18521	0.009502	0.1146489

Kohinoor Tex. Mills Ltd/ Maple Leaf Cement. (2002)									
	Before				After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	0.02998	2	-3.14923	0.08776	0.051	2	-3.14923	0.08776	-0.0210199
ROE	0.089492	2	-0.98961	0.42667	0.147021	2	-0.98961	0.42667	-0.0575832
NPM	2.130531	2	1.57414	0.256116	0.046	2	1.57414	0.256116	2.0845377

Kohinoor Textile Mills Limited (2001)									
	Before				After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	0.388	2	0.964917	0.436392	0.032863	2	0.964917	0.436392	0.3556759
ROE	0.154249	2	1.685884	0.233864	0.094282	2	1.685884	0.233864	0.0599389
NPM	0.135667	2	2.203094	0.158464	0.03843	2	2.203094	0.158464	0.0972604

Dewan Salman Fibres (2001)									
	Before				After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	0.026951	2	-0.94679	0.44368	0.180882	2	-0.94679	0.44368	-0.1539771
ROE	0.097331	2	2.332663	0.14488	0.044476	2	2.332663	0.14488	0.0528573
NPM	0.053191	2	-0.77637	0.518772	0.181667	2	-0.77637	0.518772	-0.128519

Taj Textle (1999)									
	Before				After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	0.01512	2	-2.4386	0.13494	0.04956	2	-2.4386	0.13494	-0.034436148
ROE	0.048872	2	1.811881	0.211697	-0.15343	2	1.811881	0.211697	0.202301655
NPM	0.012595	2	1.968976	0.187791	-0.06933	2	1.968976	0.187791	0.081928586

Nishat Mills (1997)									
	Before				After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	0.050601	2	0.045587	0.967782	0.049557	2	0.045587	0.967782	0.001043546
ROE	0.050601	2	0.045587	0.967782	0.049557	2	0.045587	0.967782	0.001043546
NPM	0.036746	2	6.159157	0.025362	-0.06933	2	6.159157	0.025362	0.011383554

Umer Fabrics (1995)									
	Before				After				
	Mean	df	t Stat	P value	Mean	df	t Stat	P value	Mean Diff
ROA	-0.00439	2	2.919986	0.037613	0.091034	2	2.919986	0.037613	-0.095425484
ROE	-0.03416	2	-3.54796	0.071075	0.221328	2	-3.54796	0.071075	-0.255489588
NPM	-0.00316	2	-3.69526	0.06606	0.053174	2	-3.69526	0.06606	-0.056337736

Appendix: II Summary of Results (Sig. = Significant, Insig. = Insignificant)

New Name of Company	**ROA**	**ROE**	**NPM**	**Over All Effect**
Shahzad Textile Mills Limited	Insig. & +ve	Insig. & -ve	Insig. & +ve	Mix result
Colony Mills Limited	Insig. & -ve	Insig. & -ve	Insig. & +ve	Mix result
Nishat (Chunian) Ltd. & Nishat	Sign. & -ve	Insig. & -ve	Insig. & +ve	Mix result
Dawood Lawrencepur Limited	Insig. & -ve	Insig. & -ve	Insig. & +ve	Mix result
Khinoor Weaving Mills.	Insig. & -ve	Insig. & -ve	Insig. & -ve	Insig. & -ve
Legler - Nafees Denim Mills	Insig. & -ve	Insig.& -ve	Insig. & +ve	Mix result
Nagina Cotton Mills Limited	Insig. & -ve	Insig. & -ve	Insig. & -ve	Insig. & -ve
Kohinoor Textile Mills Limited	Insig. & -ve	Insig. & -ve	Insig. & -ve	Insig. & -ve
Ibrahim Fibres	Sign. & -ve	Sign. & -ve	Sign. & -ve	Sign. & -ve
Kohinoor ./ Maple Leaf Cemen	Insig. & +ve	Insig. & +ve	Insig. & -ve	Mix result
Dewan Salman Fibres	Insig. & +ve	Insig. & -ve	Insig. & +ve	Mix result
Taj Textile	Insig. & +ve	Insig. & -ve	Insig. & -ve	Mix result
Nishat Mills	Insig. & -ve	Insig. & -ve	Sign. & -ve	Mix -ve
Umer Fabrics	Sign. & +ve	Insig. & +ve	Insig. & +ve	Mix -ve

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