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Post-Merger Analysis of Returns to Equity Shareholders: An Indian Telecom Sector Study

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Abstract: Telecom sector is one of the rapidly growing sectors in India. Mergers and acquisitions has become an ever going inevitable necessity for further growth in this sector. The aim of this paper is to establish whether these mergers result in improvement in returns to the equity holders of the acquiring Indian telecom companies. It focuses mainly on the mergers that have taken place during the period of 2008-2015. The outcomes demonstrate that most of these mergers deteriorate the returns to the shareholders though the impact is not significant.

Keywords: Mergers and Acquisitions, Telecom Sector, Return on Equity.

I. INTRODUCTION

The telecom sector has been one of the primary drivers of India's economic growth – contributing 6.5% to the national GDP. The industry has invested INR 9.2 Lakh Crores while attracting the highest FDI of INR 1.1 Lakh Crores in the last two decades. It has also created 22 Lakh direct and 18 Lac indirect jobs. All of this has been achieved while providing telecom services at the lowest tariffs in the world. (Source: COAI Annual Report 2016-17). India is currently the world's second-largest telecommunications market with a subscriber base of 1.21 billion as of July 2017 (source: BMI (Business Monitor International) Report, Internet Mobile Association of India (IAMAI)) and has registered strong growth in the past decade and half. The Indian mobile economy is growing rapidly and will contribute substantially to India's Gross Domestic Product (GDP), according to report prepared by GSM Association (GSMA) in collaboration with the Boston Consulting Group (BCG). Reforms implemented by Telecom Regulatory Authority of India (TRAI) and Department of Telecommunications (DoT) post liberalization have drastically altered the business environment in the Indian telecom sector. The liberal and reformist policies of the Government of India have been instrumental along with strong consumer demand for the rapid growth in the Indian telecom sector. The government has enabled easy market access to telecom equipment and a fair and proactive regulatory framework that has ensured availability of telecom services to consumer at affordable prices. The deregulation of Foreign Direct Investment (FDI) norms has made the sector one of the fastest growing and a top five employment opportunity generator in the country. In such a hyper competitive telecom industry, to remain in competition most of the firms are taking the inevitable merger and acquisition route.

This paper aims at exploring the impact of M & As on the Telecom Sector. It studies few prominent mergers and acquisitions deals by the Indian Telecom Companies during the timeframe spanning from 2008-2015. The focus of this study is to measure the change in ROE levels of the companies, if any, in the post-merger phase as compared to the pre-merger.

II. REVIEW OF LITERATURE

Scholastic enthusiasm for mergers and acquisitions was first perceived in the 1960s (Kitching, 1967) and there are countless investigations concentrating on the effect of such a marvel on the diverse money related parameters.

Khemani (1991) examined the numerous factors that impact the decision of merging with another firm and reasoned that profitability was a definitive goal.

Al-Sharkas et. al. (2010) concentrated on unusual returns for bidder, target and combined firms in bank mergers. The results uncovered that there is a positive impact on the shareholders' wealth because of M&A.

Similar studies were also conducted in India. Rao and Rao (1987) attempted to investigate mergers in India. In the post 1991 period, a few scientists have endeavored to consider mergers and acquisitions in India (Beena (1998), Roy (1999), Das (2000), Saple (2000), Kumar (2000), Pawaskar (2001) and Mantravedi and Reddy (2008)).

Asquith (1983), Jensen and Ruback (1983), Stegemoller (2001), Conn., C., Cosh, A., Guest, P. and Hughes, A. (2001), Fueller (2002), Selden (2003), Conn (2004), Moeller (2004), Jose Manuel Campa & Ignacio Hernando (2005), Aybar and Ficici (2009), Sougata Ray and Sathyajit R Gubbi (2009), Bhagat, Malhotra and Zhu (2011), Kohli and Mann (2011), Sun et al. (2012), Lamba and Tripathi (2013), etc have predominantly used stock market based performance measurement, i.e standard event study methodology. Most of these studies employ market model and calculate the cumulative abnormal returns over short event windows around announcement period of 2- to 5-day in order to measure shareholder wealth changes.

While, it is argued that short-run market model represents a direct measure of stock-holder value (Lubatkin and Shrieves, 1986), it is important to point out that, it measures investors' expectations and not realized performance (Montgomery and Wilson, 1986; Schoenberg, 2006).

Given the concerns surrounding the short-term performance, a number of researchers such as Lougran and Vijh (1997) have used accounting measures (Agrawal and Jaffe, 2003; Agrawal et al., 1992; Healy et al., 1992).

However, Soongswang (2010) and Bhagat et al., (2011) have used Buy and Hold Abnormal Returns in the context of emerging markets with no study using long-term accounting based performance measures such as cash flows; and return of assets. For example, long-term accounting based measures recognize the synergies obtained in the long-term and are a direct opposite to short-term cumulative abnormal returns (Hitt et al., 1998).

Given that the predominant motives for undertaking M&As are 'to acquire strategic assets' and 'develop the market' which take time to achieve, Boateng et al (2012) used long-term performance measures such as long-term accounting, ex post assessment of senior managers after acquisition and stock market based measures to evaluate performance for capturing long-term synergies accruing from the acquisitions.

There are few researches related to M&As in Telecom Industries.

The empirical study conducted by Park et. al. (2002) had profound impact in the research field related to M&A in the telecom sector. They investigated how market participants react to M&A involving telecommunications companies. The evidence suggested that such activities convey bad news to the market, to the shareholder value and a cross-border deal, rather than a domestic M&A deal, was the main driver of the negative market reaction. This suggested that value creation or synergy through an M&A deal was not a warranty even though it can generate an increase in size of the firm.

Petkova, M. and Do, T.Q. (2012) explored whether the European acquirers in the telecom sector failed to deliver value to their shareholders in the period ranging from 1995 to 2005 and also discussed the possible motives behind the intentions to engage in M&A. The main inference drawn from the study was that acquisitions in general fail to create value to the shareholders, which might be due to many factors. They concluded that despite the negative evidence concerning post-acquisition performance, firms still choose to engage in acquisitions on account of external or internal motives.

Majumdar, S. K. et. al. (2009) evaluated the impact of the various mergers of the local exchange companies in the United States telecommunications industry that have taken place between 1988 and 2001 on technology investment levels among the firms. They conceived that the 'efficiency defense' for merger approvals did not hold and the findings call into question the validity of fundamental tenets of contemporary competition policy.

Yaylacicegi, U. (2005) explored the consequences of mergers and acquisitions in the telecommunications industry for the period 1988 to 2001 and established a significant evidence that mergers were followed by substantial deterioration in profitability and operational performance, in addition to a significant decrease in the investment on new technology.

III. Research Gap

Many firms consider Mergers and Acquisitions as a mean of growth in this competitive world. Hence, it becomes important to understand whether mergers of firms have led to a better performance or not. Because, only then one can justify the use of mergers as an important tool of corporate strategy.

Numbers of studies have been conducted on performance evaluation of M&A, which have assessed M&A outcomes using different parameters. In spite of a substantial volume of literature, the debate about whether mergers are wealth creating or wealth reducing for the firms that are involved is a never ending one. No definite conclusion can be drawn from the various researches as they are contradictory to each other.

Also, most of these studies relate to developed economies, which cannot be generalized for Indian mergers. Thus, there is a need to explore this area further.

Moreover, Indian service industry is thriving rapidly and Telecommunications industry is one of the most profitable and rapidly developing industries in the country. The Indian telecom sector has registered a phenomenal growth during the past few years and has become second largest telephone network in the world, after China. It is one of the few sectors in India which has witnessed the most fundamental structural and institutional reforms since 1991. The number of mergers and acquisitions in Telecom Sector has been increasing significantly. Hence, it becomes necessary to study the outcomes and impact of these mergers.

It is said that the foremost important objective of any business should be to maximize the wealth of its shareholders. Thus, in case of a merger which is said to be a way for easy growth of a company, it becomes necessary to check whether it is really beneficial to its shareholders or not. And, what better measure than Return on Equity can one have to measure the impact of Merger on Shareholders' wealth.

IV. Research Problem

Is there a significant impact of mergers and acquisitions on the Return on Equity of the acquiring companies in Telecom sector in India?

V. Hypothesis of the Study

H0: There is no significant impact of mergers and acquisitions on the Return on Equity of the acquiring companies in Telecom sector in India.

VI. Alternative Hypothesis

H1: There is a significant impact of mergers and acquisitions on the Return on Equity of the acquiring companies in Telecom sector in India.

VII. RESEARCH METHODOLOGY

The objective of this study is to explore the impact of mergers and acquisitions on the acquiring company's ROE in the telecom sector of India. We aim to comprehend whether M&A in this sector have led to the improvement in performance of the merging firms or has the performance deteriorated after the merged entity was formed.

From the Bloomberg Database it was found that 6 Indian Telecom Companies listed on Indian Exchanges have undergone M&A during the period 2008-2015. Total 35 M &As have taken place (Annexure 1) in these companies in the said period. Out of those 35, leaving out cross border mergers, mergers with subsidiaries of the acquiring companies and overlapping M&As, only 11 Mergers are left to study (Annexure 2). These 11 mergers were selected as the subject of this paper. The timeframe of the study was 8 years i.e. 2008-2015. An attempt is made to trace the outcome of the M&A deals in the Indian Telecom Sector by examining the 5 companies listed on Indian Exchanges which are as follows: Bharti Airtel Ltd., Idea Cellular Ltd, GTL Infrastructure Ltd, Reliance Industries Ltd and Reliance Communications Ltd. In case where a company has undergone multiple acquisition only the most recent one is taken into consideration.

This study is based on a short run analysis of two periods - three years prior to the merger and three years immediately after the merger. The secondary data which has been collected was subjected to descriptive and inferential analysis. This research work tried to test the hypotheses relating to the impact of merger and acquisition on Return on Equity of acquiring company and thus derive at conclusion about whether the event of merger and acquisition has made an impact on the performance of these firms. The statistical software SPSS and MS Excel were used to compute and analyze the data.

The Return on Equity for each of the acquiring company is calculated individually using the below given formula:

ROE = (PAT-Preference Dividend) / Shareholders' Equity

Wherein **Shareholders' Equity** consists of **Equity Share Capital** and **the total Reserves and Surplus.**

ROE is a true bottom-line profitability metric, comparing the profit available to shareholders to the capital provided or owned by shareholders. In a conceptual sense, it's the profitability measure that equity investors care most about. Whereas return on assets and return on invested capital each depict a variant of profitability available to both debt and equity investors, ROE stays pure, comparing the income available to just equity investors to the capital owned (and put to work) by just equity investors.

VIII. DATA ANALYSIS AND CONCLUSION

Relevant data related to the ROE for the five Indian Telecom companies that went through Merger during the period under study (2008-2015) was collected three years prior and three years after the merger event.

Acquirer Name	Pre-merger ROE			Post-merger ROE			Pre-merger ROE Average	Post-merger ROE Average
	T - 3	T - 2	T -1	T+1	T+2	T+3		
Bharti Airtel Ltd	25.17	13.3	8.57	5.04	8.52	9.44	15.68	7.67
Idea Cellular Ltd	37.69	35.62	36.42	10.17	7.43	7.44	36.58	8.35
GTL Infrastructure Ltd	0.23	-7.06	-0.14	-29.26	-41.77	-55.87	-2.32	-42.30
Reliance Industries Ltd	12.19	11.88	11.82	11.3	13.22	12.07	11.96	12.20
Reliance Communications Ltd	17.17	16.95	10.87	3.21	2.42	1.92	15.00	2.52

Below given table compares the Pre- and Post-Merger average ROEs of these companies.

Acquirer Name	Pre-merger ROE Average	Post-merger ROE Average	Impact on ROE
Bharti Airtel Ltd	15.68	7.67	Negative
Idea Cellular Ltd	36.58	8.35	Negative
GTL Infrastructure Ltd	-2.32	-42.3	Negative
Reliance Industries Ltd	11.96	12.2	Positive
Reliance Communications Ltd	15	2.52	Negative

By comparing the Pre- and Post-Merger average ROEs of these companies, one can see that four out of five firms involved have experienced deterioration in the wealth of the shareholders after the merger event.

In order to test the hypothesis, paired samples T test was applied to this data, by using SPSS.

The outcome of the analysis is listed below:

Paired Samples Statistics

		Mean	N	Std. Deviation	Std. Error Mean
Pair 1	Pre-Merger Avg ROE	15.3800	5	13.91636	6.22359
	Post-Merger Avg ROE	-2.3120	5	22.61805	10.11510

Paired Samples Correlations

		N	Correlation	Sig.
Pair 1	Pre-Merger Avg ROE & Post Merger Avg ROE	5	.703	.185

Paired Samples Test

		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	Pre-Merger Avg ROE - Post Merger Avg ROE	17.6920	16.20391	7.24661	-2.42781	37.81181	2.441	4	.071

The T value corresponding to the mean difference between the pre and post-merger ROE was 2.441 and its corresponding p value is 0.071 > 0.05. Since the p value is more than 0.05, we can conclude that there is no significant impact of Merger on ROE of acquiring Indian Telecom companies. Hence null hypothesis can be accepted and we can deduce that the phenomenon of merger did not have any significant impact on the Return on Equity of the companies in the post-merger period.

This finding is consistent with the studies conducted by Park et. al. (2002), Yaylacicegi, U. (2005), Mantravadi and Reddy (2008), Kohli (2008), Mahesh R and Daddikar (2012), etc. who opine that the mergers do not have significant impact on financial performance of the merged firms.

IX. Scope for Further Study

- Few researchers have concluded that acquisitions are either value neutral or value losing propositions for acquirers. Even this study suggest that 'there is no impact on ROE of an acquiring Indian Telecom firm because of Merger'. However, this has not dampened the zeal of companies to make acquisitions. Considering research conclusions on acquisitions, why do companies continue to acquire? Thus, there is a scope for further research on this topic
- The present study has made an analyses of mergers in Telecom Sector in India. However, M&A activity taking place in India is not limited to Telecom Sector alone. Hence, research in the other sectors needs to be taken up.
- The study has assessed success or failure of mergers in terms of its impact on Return on Equity. Other financial aspects of mergers have not been touched. Gauging the success of mergers through this aspect could be another area of research.

Long run success of mergers can be analyzed by taking a longer time period, say five to seven pre and post-merger years.

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Annexures and Graphs:

Annexure 1

Sr No	Announce Date	Target Name	Acquirer Name	Announced Total Value (mil.)	Payment Type
1	2-May-13	Airtel Bangladesh Ltd	Bharti Airtel Ltd	N/A	Undisclosed
2	5-Feb-13	Alcatel-Lucent Managed Network Service India	Bharti Airtel Ltd	N/A	Undisclosed
3	11-Aug-10	Telecom Seychelles Ltd	Bharti Airtel Ltd	62	Cash
4	12-Jan-10	Airtel Bangladesh Ltd	Bharti Airtel Ltd	300	Cash and Stock
5	25-Jun-08	Spice Communications Ltd	Idea Cellular Ltd,Axiata Group Bhd	719.8	Stock
6	25-Jun-08	Spice Communications Ltd	Idea Cellular Ltd	509.16	Cash
7	16-Dec-10	Chennai Network Infrastructure Ltd	GTL Infrastructure Ltd	853.59	Stock
8	14-Jan-10	Tower portfolio	GTL Infrastructure Ltd	1756.62	Cash
9	24-Nov-14	Sentient Technologies Inc	Tata Communications Ltd,Private Investor,Access Industries LLC,Horizons Ventures Ltd	103.5	Cash
10	11-Jan-11	BitGravity Inc	Tata Communications Ltd	N/A	Undisclosed
11	18-Jan-10	Mosaic platform business	Tata Communications Ltd	N/A	Cash
12	24-Jun-08	Neotel Ltd	Tata Communications Ltd	N/A	Undisclosed
13	29-May-14	Network 18 Media & Investments Ltd	Reliance Industries Ltd	602.07	Cash
14	29-May-14	TV18 Broadcast Ltd	Reliance Industries Ltd	228.72	Cash
15	29-May-14	TV18 Broadcast Ltd	Reliance Industries Ltd	34.7	Cash
16	29-May-14	Network 18 Media & Investments Ltd	Reliance Industries Ltd	0.22	Cash
17	29-May-14	Infomedia Press Ltd	Reliance Industries Ltd	0.08	Cash
18	28-Sep-12	BP Chemicals Malaysia Sdn Bhd	Reliance Industries Ltd	371.52	Cash
19	5-Mar-12	EIH Ltd	Reliance Industries Ltd	N/A	Undisclosed
20	22-Dec-11	TerraPower LLC	Reliance Industries Ltd	N/A	Undisclosed
21	8-Nov-11	Extramarks Education Pvt Ltd	Reliance Industries Ltd	N/A	Cash
22	30-Aug-10	EIH Ltd	Reliance Industries Ltd	217.62	Cash
23	5-Aug-10	Marcellus Shale Properties	Reliance Industries Ltd	327	Cash
24	5-Aug-10	Marcellus Shale Properties	Reliance Industries Ltd	13	Cash
25	24-Jun-10	Eagle Ford Shale	Reliance Industries Ltd	266	Cash
26	11-Jun-10	Reliance Jio Infocomm Ltd	Reliance Industries Ltd	1024.71	Cash
27	16-Apr-10	Deccan 360	Reliance Industries Ltd	25	Undisclosed
28	9-Apr-10	Marcellus Shale position	Reliance Industries Ltd	340	Cash
29	2-Mar-09	Reliance Petroleum Ltd	Reliance Industries Ltd	1752.21	Stock
30	27-Feb-09	Reliance Petroleum Ltd	Reliance Industries Ltd	263.98	Cash
31	22-Apr-08	eOfficePlanet	Office Depot Inc,Reliance Industries Ltd	N/A	Undisclosed
32	24-Jan-12	AnComm Inc	Reliance Communications Ltd	N/A	Undisclosed
33	1-Jul-10	Digicable Network India Pvt Ltd	Reliance Communications Ltd	1570.87	Stock
34	26-May-08	Reliance Vanco Group Ltd	Reliance Communications Ltd	76.9	Cash
35	24-Apr-08	eWave World Ltd	Reliance Communications Ltd	N/A	Undisclosed

Annexure 2

Sr No	Announcement Date	Target Name	Acquirer Name	Announced Total Value (mil.)	Payment Type
1	5-Feb-13	Alcatel-Lucent Managed Network Service India	Bharti Airtel Ltd	N/A	Undisclosed
2	25-Jun-08	Spice Communications Ltd	Idea Cellular Ltd,Axiata Group Bhd	719.8	Stock
3	16-Dec-10	Chennai Network Infrastructure Ltd	GTL Infrastructure Ltd	853.59	Stock
4	14-Jan-10	Tower portfolio	GTL Infrastructure Ltd	1756.62	Cash
5	29-May-14	Network 18 Media & Investments Ltd	Reliance Industries Ltd	602.07	Cash
6	29-May-14	Infomedia Press Ltd	Reliance Industries Ltd	0.08	Cash
7	8-Nov-11	Extramarks Education Pvt Ltd	Reliance Industries Ltd	N/A	Cash
8	30-Aug-10	EIH Ltd	Reliance Industries Ltd	217.62	Cash
9	16-Apr-10	Deccan 360	Reliance Industries Ltd	25	Undisclosed
10	22-Apr-08	eOfficePlanet	Reliance Industries Ltd, Office Depot Inc	N/A	Undisclosed
11	1-Jul-10	Digicable Network India Pvt Ltd	Reliance Communications Ltd	1570.87	Stock