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THE IMPACT OF MERGERS AND ACQUISITIONS ON THE OPERATIONAL PERFORMANCE OF COMPANIES IN EMERGING CAPITAL MARKETS

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Abstract

Modern trends in economic development, characterized by increased competition and globalization of markets, lead to a significant increase in mergers and acquisitions (M&A). Companies from emerging capital markets are beginning to play an increasingly significant role in these processes. It is very necessary to identify whether M&A deals create value for companies or are they just a convenient way for management to expand and strengthen its position. The article presents the results of a study of the effectiveness of transactions for the transfer of corporate control on a sample of companies from the BRICS countries in the period from 2009 to 2012. Based on the method of analysis of financial statements, we found an increase in the operating indicators of companies (EBITDA / Sales) as a result of mergers and acquisitions two years after their completion. The main determinants of the effectiveness of transactions initiated by companies from the BRICS countries are: deal size of acquitting company, friendly focus of the transaction and the stake share.

Keywords: Mergers and acquisitions, BRICS, capital movement, emerging markets.
JEL Codes: G34, F21.

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1. Introduction

One of the forms of business restructuring, expressed in reorganization changes in order to increase the company or create added value, value are mergers and acquisitions. Mergers and acquisitions of companies spread in the United States in the late 19th century, when American industry began to move from small and medium-sized enterprises to multinational corporations.

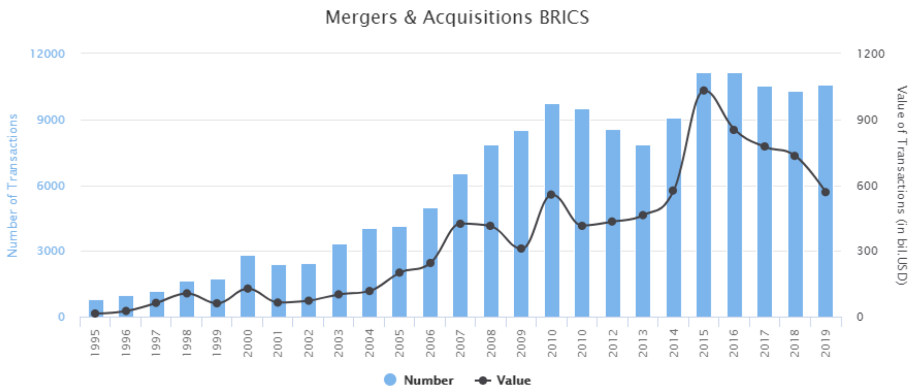
Merger - an operation that merges two or more companies. Takeover - the acquisition of control over a target company by purchasing more than 50% of its shares. The term is most used when referring to a hostile takeover. Acquisition - an operation as a result of which one company acquires another or part of it.

The problem of mergers and acquisitions is actively discussed in the academic literature. In recent years, it has gained relevance due to the growing uncertainty in the financial markets, as well as due to unprecedented global investment deals, many of which have failed. At the same time, emerging markets, and especially the markets of the BRICS countries, are becoming the main center of activity. Currently, companies from emerging markets are involved in every fourth M&A deal (Boston Consulting Group, 2013), and representatives of the BRICS countries, primarily Chinese, are the leaders (Sehgal et al., 2015).

In recent years, the global M&A markets have seen some decline. Analysis of the effectiveness of mergers and acquisitions by the Boston Consulting Group (BCG) agency (Boston Consulting Group, 2017), based on the excess return method, showed that, in general, the acquisition of another public company by a public company led to the destruction of the value of the acquiring company, both in the short term and in the long run. But it can also create substantial returns to the companies. According to BCG study destruction analysis are generally made with respect to acquirers' shareholders. But if to consider the targets' investors 1.8% of combined gain can be found from 56% of deals that create values. 2019 BCG report on M&A summarizes 2018 data like the value created by global M&A increased by 7%, but volume of transactions declined by 3%, and reach to 35,800 transactions during the year.

According to the World Bank report for 2018 the total population's 40% and total world GDP's 24% (20.2 trillion) is contributed by BRICS countries. Since the end of 2014 the role of the BRICS countries in merger and acquisitions is constantly growing (Thomson Reuters, 2014). The undoubted leader is China: 43% of the total number of transactions. India ranks in the second place with 27% of total deals, Russia is in the third place with 14%. Brazil ranks fourth in the ranking with 11 % and South Africa respectively in fifth rank with 5%. Total deals by BRICS can be recorded as 10565 deals with the value of $567.94805 in 2019. (See graph 1) (BCG report,2019)

Graph 1. BRICS- Merger and acquisitions statistics



Source: IMAA database

There are several reasons for the high activity of companies from the BRICS countries in mergers and acquisitions. First, it is the high rate of return inherent in emerging markets. Secondly, high rates of economic growth of relatively developed markets, which promotes mergers and acquisitions, have three key investment motives: access to energy and natural resources; access to fast-growing consumer goods markets; and the desire of BRICS companies to gain access to management and manufacturing technologies in developed markets. According to Khanna and Palepu (2009), the diffusion of skills, processes and technologies in the global market brings together developed markets and high-growth economies, but as long as this gap exists between those countries, it offers additional incentives for companies to develop.

In addition to access to technology, BRICS acquirer companies may have specific incentives to pursue M&A deals. Thus, for Chinese and Indian companies, access to premium brands of companies from developed countries may be an important motive for completing a transaction, which allows them to differentiate from competitors (Sehgal et al., 2015). An example of such a deal was the 2010 acquisition of the premium Swedish manufacturer Volvo from Ford Motor Company by private Chinese automaker Geely. The deal was intended to increase the company's competitiveness in the Chinese market, which was dominated by state-owned enterprises, and to promote its internationalization. For Russian companies, a common motive for acquiring companies is the benefits of vertical integration, as well as the opportunity to invest accumulated cash in undervalued assets. (Musatova, 2011)

2. Literature Review

A review of scientific research conducted on data from companies with developed capital markets highlights the following methods used to assess the effectiveness of M&A: event study analysis, accounting studies, surveys of executives, analysis of specific situations (Bruner, 2001; Lu, 2008). To conduct empirical research, the first two methods are most often used. The accumulated excess return method is based on studying the reaction of the stock market to announcements of mergers and acquisitions and makes it possible to assess the impact of transactions on the value of companies in the short term. The analysis of financial statements involves the comparison of financial indicators of the companies participating in the transaction for a certain period before and after its completion, i.e. allows you to determine the operational efficiency of M&A transactions in the long term (usually more than one year). The main source of information in this case is not the stock market, but the financial statements of companies according to certain financial reporting standards. The most commonly used financial indicators are OCF / TMV (operating cash flow / total market value of assets), ROA (return on assets), ROE (return on equity), EBITDA / Sales (profit before interest, taxes and depreciation / revenue) and others.

The results of foreign studies based on the accumulated excess return method indicate that target companies, as a rule, benefit from M&A deals. The values of accumulated excess returns in the most recent works vary from 5 to 45% (Schwert, 1996; Eckbo, Thorburn, 2000; Campa, Hernando, 2004). The profitability for acquirer companies differ depending on transactions and in different studies their values can be either positive or negative or equal to zero (Baker, Limmack, 2002; Moeller et al., 2007; Bradley, Sundaram, 2006; Hackbarth, Morrelec, 2008; Hamza, 2009).

The reason of discrepancies between the studies can be explained by number of samples, the observation period, and method used for predicting normal stock returns. The recent investigation on the operational efficiencies of M&A deals were based on the method of analyzing financial statements. Studies using companies as financial indicators - indicators based on cash flows, as a rule, indicate an improvement in the operating efficiency of companies as a result of M&A transactions, while studies based on indicators like profit and profitability of companies (ROA, ROE , EPS, etc.), prove its decline as a result of commenced transactions. The other reasons for the discrepancy between the results of empirical studies can also be differences in the economic situation of the countries of the companies participating in the transaction, dissimilarities in accounting and tax accounting in different countries, the size of the studied sample, in the time period of the study, the selected financial indicators and the applied research methodology (Bruner, 2001).

In general, the authors of the studies assessing the market reaction to announcements of mergers and acquisitions in the BRICS countries conclude that this information has a positive effect on share prices. For example, Wong et al. (2009), examines excess returns in 95 M&A deals and 563 acquisitions in Asian capital markets, including Chinese, in the time frame from 2000 to 2007 before, during and after the deal was announced. The author concludes that in the period prior to the announcement of the acquiring company's CAAR (Cumulative average abnormal returns) deal, it is already positive (2.72%) and is statistically significant at the 10% significance level. This means that investors overestimate its effectiveness at the time of rumors about the deal and are inclined to buy up shares before the official announcement. As new information about the terms of the deal or the financial statements of its participants becomes available, many investors change their position, which is reflected in the value of the average accumulated return - at the time of the announcement of the deal, it becomes insignificant. However, after the announcement of the deal, CAAR peaks at 9.2%, which is statistically significant at the 1% level. And this in turn means that in the short term, information about the transaction has a positive impact on the yield of shares of Asian companies involved in mergers and acquisitions.

In the article by Grigorieva and Petrunina (Grigorieva, Petrunina, 2013), the authors applied both approaches: the assessment in the short term was carried out using the event analysis method, and in the long term, based on financial statements. Analyzing a sample of 80 deals made by firms in emerging capital markets between 2002 and 2009, the authors conclude that deals erode the acquirer's value. The analysis of long-term performance showed a negative relationship between financial performance before and after the transaction. For EBITDA / Sales the difference was -3.3%. Results for a short-term assessment of the impact of deals on company value showed that the announcement of the deal results in high returns for acquired companies, while for acquirers, returns vary depending on the length of the event window.

The sample size in contemporary works ranges from 20 transactions (Tsung-Ming, Hoshino, 2000) to 859 (Heron, Lie, 2002). If earlier studies mainly analyzed data for the United States, then more and more works built based on data from companies in Europe and other countries have been observed recently. The observation time has also gradually increased due to the improvement in the regularity and accuracy of statistical data - from 1 to 10 years. Although the latter is rather an exception to the rule, the bulk of research has been carried out for 3-5 years.

Studies of the effectiveness of mergers and acquisitions have been conducted mainly in developed capital markets, while the effects of transactions in emerging markets have been studied much less. According to Khanna and Palepu (Khanna, Palepu, 1997, 2000), the integration strategy can be more effective in these markets due to the underdeveloped institutional environment. Only a few academic works based on data from Slovenia, Poland, China, India and Turkey have been devoted to testing this hypothesis (Pawaskar, 2001; Trojanowski, 2002; Beena, 2004; Gregoric, Vespro, 2009; Pop, 2006; Changqi, Ningling, 2010 ; Ho-Mou Wu, 2009; Mantravadi, Reddy, 2008).

The study of the impact of M&A transactions on the operational efficiency of companies is presented in the work of Mantravadi, Reddy (2008). Based on a sample of 118 M&A deals initiated by Indian companies between 1991 and 2003, the authors concluded that mergers and acquisitions, on average, lead to lower return on capital employed (ROCE) indicators for companies - buyers three years after the completion of transactions. Authors also found that the industry affiliation of companies affects the change in the studied financial indicators.

Studying the reaction of the stock market to the announcements of 128 M&A deals in the period from 2000 to April 2008 in emerging capital markets, E.V. Chirkova, E.V. Chuvsvina (Chirkova, Chuvsvina, 2011) found that the market reacts differently to transactions for the acquisition of public and private companies, while assessing the acquisition of the latter more favorably. The authors also tried to explain the reasons for the difference found by studying the influence of various factors on the indicators of accumulated excess returns: the activity of the corporate control market, the method of financing the transaction, the acquired share of the target company, and others.

The work of Ho-Mou Wu (2009) is devoted to the simultaneous use of the event method and the analysis of financial statements. The author examines M&A transactions of 1,086 companies (1,363 transactions) between 2004 and 2005, listed on the Shanghai and Shenzhen Stock Exchanges. In addition to considering the efficiency directly, the author tries to identify the determining factors of the latter: the state of the stock market, the ownership structure, the year of the transaction. The negative values of accumulated excess returns obtained by the author in 2004 indicate the destruction of the value of companies as a result of M&A transactions. When dividing the sample into transactions carried out by public and private companies, it was found that the accumulated excess returns are negative for the former and positive for the latter. In 2005, excess returns are positive for both state-owned (1.83%) and private companies (1.11%). The efficiency of M&A transactions in 2005 also confirms the growth of financial indicators of the companies participating in the transaction.

The opposite of the conclusions of empirical works, a small number of studies based on data from individual developing countries, necessitate further study of the effectiveness of M&A transactions, as well as identify the factors that determine it.

3. Data and Methodology

The empirical analysis is based on the method of analysis of financial statements that allows to evaluate the effectiveness of M&A transactions on a long-term horizon. Thus, this work develops the study of the impact of M&A transactions on the performance of companies in the BRIC countries (but considering South African countries as well), presented in the work of S.A. Grigorieva and performed using the accumulated excess return method. To measure the operational efficiency of M&A transactions, the EBITDA / Sales ratio was used. EBITDA has been chosen as a proxy for operating cash flow, which has been studied in most studies in developed capital markets (Grigorieva, 2011).

Financial statement analysis method involves comparing the studied indicator before and after the integration of companies. The accounting statements of the companies were reviewed for two years before and after the completion of the transaction, so the research was done for four years, [-2; +2].

To assess the effectiveness of M&A transactions, this study uses an industry adjustment model proposed by Healy et al. (1992).

$$\left(\frac{EBITDA}{SALES}\right)^{ind}_{after,i} = \alpha + \beta\left(\frac{EBITDA}{SALES}\right)^{ind}_{synthetic(before),i} + \varepsilon_i$$

where:

$\left(\frac{EBITDA}{SALES}\right)^{ind}_{after,i}$-Industry-adjusted EBITDA / Sales of combined company i, two years after completion of the transaction;

$\left(\frac{EBITDA}{SALES}\right)^{ind}_{synthetic(before),i}$-industry-adjusted synthetic value EBITDA / Sales for the acquiring company and the target company two years before the M&A transaction;

α - reflects the change in EBITDA / Sales of companies (abnormal EBITDA / Sales, not

depending on the value of EBITDA / Sales before the transaction) - the criterion of the effectiveness of M&A transactions;

β - reflects the correlation between EBITDA / BV (book value) Assets before and after the M&A transaction.

This model will contirubte in testing the hypothesis stating that M&A deals in the BRICS countries do not lead to a decrease in the operating efficiency of the companies participating in the deals. So:

$$\left(\frac{EBITDA}{SALES}\right)^{ind}_{after,i} \geq \left(\frac{EBITDA}{SALES}\right)^{ind}_{synthetic(before),i}$$

The five most promising growing emerging markets - Brazil, Russia, India, China, South Africa countries (BRICS) were selected for making analysis. Data is obtained from IMAA institute database and Bloomberg database, meanwhile PrivCo, database ZEPHYR from Bureau and Corporate Affliation databases are used. The studied sample included M&A transactions completed in the period from 2009 to 2012.

The main criterias that were considered reagrding merger and acquisitions transaction can be summarized below:

1. Deal condition: Mainly the completed deals are included to the analysis.
2. The volume of the transactions. The volume of the completed transaction is of great importance in the analysis of mergers / acquisitions. A priori inclusion of "small" deals in the study would lead to an insignificant impact of the transaction on the operating performance of the companies. For this study the optimal threshold value is the size of the transaction, which is at least 10% of the capitalization of the buying company.
3. The size of the purchased company. The final sample included transactions, as a result of which a controlling stake (50%) was consolidated, giving the undeniable right to manage the company's financial flows.
4. Characteristics of the companies participating in the transaction. The sample included public companies whose financial statements were in the public domain and the data that can be obtained from above-mentioned databases. Excluded companies that were excluded include: Firms operating in the financial sector and regulated companies (since this type of evaluation method is not appropriated for them), companies involved in several major M&A deals.

During the selected time period, 365 M&A transactions were completed in the

BRICS countries, meeting criteria 1-3. Due to the lack of data on the analyzed indicators, the sample was reduced to 82 M&A transactions. It turned out that 66 transactions (80% of the total sample) are friendly transactions within the same industry.

The result of analysis of oerational efficiency of the M&A transactions during stated period in BRICS is stated in the Table 1.

Table 1. Result of analysis of oerational efficiency

	α	*β*	R^2	*Significance F*
Industry-adjusted operating efficiency 2 years after M&A				
EBITDA/SALES	0,064	0,711	0,46	0,01
p values	(0,03)	(0,01)		

*** the result is significant at the 1% level

** the result is significant at the 5% level

* the result is significant at the 10% level

Source: Compiled by the author

As can be seen from the result stated in Table 1, the value of α is positive for a four-year period, [-2; +2] years, and statistically significant at the 5% level. The obtained result testifies to the growth of operating efficiency of companies as a result of M&A transactions. Thus, tested hypothesis cannot be rejected at the 5% significance level for mergers and acquisitions initiated by companies from the BRICS countries.

The next step of analysis will be the identification the main determinants that influence the effectiveness of M&A transactions. As possible determinants of the effectiveness of M&A transactions in the scientific literatures, usually considered: the method of financing the transaction, Tobin's Q value, financial leverage, ways of payment, transaction size, level of investment in research and development, types of the deal, acquiring industries' industry profile, the friendliness of the transaction, the connectedness of the businesses of the merging companies, as well as various indicators of corporate quality, company management and etc. (Swanstorm, 2006; Moeller et al. 2007, Glegg et al., 2010). The following Table 2 summarizes the M&A research antecedent (Opoku-Mensah et.al, 2019).

Table 2. M&A research antecedent

BRICS M&A	
Value creation	*Leadership*
Competitive advantages (technology, entrepreneur, managerial expertise) International exposure Expansion	CEO's direct experience CEO's national pride
Firm characteristics	*Environment*
Location Age and previous acquisitions experience Industrialized level of firms The level of R&D Others (Ownership of target firms, firms valuation, capital structure, Issues of human resource management)	Industry factors Cultural distance Institutional environments environmental uncertainties
	Managerial self-interest
	Agency conflict between managers and owners *Due diligence* Cultural audit

Source: Opoku-Mensah et.al, 2019

This study examined the impact of characteristics of M&A deals on their effectiveness. Based on the collected information, the following final model was tested in the work:

$$\left(\frac{EBITDA}{SALES}\right)^{ind}_{after,i} = \alpha + \beta\left(\frac{EBITDA}{SALES}\right)^{ind}_{synthetic(before),i} + \beta_2(\text{DEALSIZE}) + \beta_3(\text{FREN}) + \beta_4(\text{DATE}) + \beta_5(\text{ACQSTAKE}) + \varepsilon_i$$

The explanatory variables, which are possible determinants of operational efficiency, are summarized in Table 3.

Table 3. Determinants of operational efficiency

Determinant	Description and calculation method
DEAL SIZE	Trading size. Calculated as the ratio of the transaction value to the market capitalization of the buying company
FREN	A dummy variable that takes the value 1 if the deal is friendly, and 0 if not
DATE	A dummy variable that takes on the value 1 if the deal was completed in the same year in which it was announced, and 0 otherwise
ACQSTAKE	A dummy variable that takes on the value 1 if more than 50% of stakes of company was acquired and 0 otherwise

Source: Compiled by the author

The model that is proposed was testes for the presence of multicollinearity using and heteroscedasticity using the White and Glaser tests. For all regressors, the VIF values were less than 4, this in tern implies that there is no precense of multicollinearity. Conducted tests for heteroscedasticity at a significance level of 0.05 did not reveal it.

The results of the regression analysis presented in Table 4 indicate two factors that have a statistically significant effect on the operational efficiency of transactions - DEAL SIZE (value -0.21) at the 10% significance level, FREN (value +0.11) at the level significance of 10%.

Table 4. Summary results

Variable	***Coefficient value (t-statistics)***
Intercept	0,11 (1,96**)
$\left(\frac{EBITDA}{SALES}\right)^{ind}_{synthetic(before),i}$	0,753 (7,64***)
DEALSIZE	-0.13 (-1,93*)
FREN	0.11 (1,98*)
DATE	-0,08 (-1,62)
ACQSTAKE	1.45 (2.15**)
Sample observations 82	
R^2 0.69	

*** the result is significant at the 1% level

** the result is significant at the 5% level

* the result is significant at the 10% level

Source: Compiled by the author

A negative relationship between DEALSIZE and operational efficiency may indicate a systematic overpayment by buying companies in mergers and acquisitions. The costs of integrating the acquired company into the activities of the initiating company is more thatn any gains from growth opportunities and economies of scale, and overpayments by acquirer companies. Acquisitions of relatively small companies are easier to carry out, and this increases the probability of positive outcome.

The positive relationship between the FREN indicator and the operational efficiency of transactions indicates that in friendly transactions, the buying companies, as a rule, have more complete information about the activities and financial condition of the company - the goals, in addition, the managers of the company do not interfere with the transaction, which saves significant funds the acquired company and has a positive effect on the company's operations after the transaction.

The positive relationship between stakeacquisiton 50% more and operational efficiency indicates that with majority stake acqusition the likelyhood that the merger will be successful and operationally efficicien is higher.

4. Conclusion & Result

Empirical research on a sample of BRIC companies found that mergers and acquisitions lead to increased operational efficiency companies participating in the transaction. The results are consistent with the findings of the study by Ramaswamy and Wegelein, who investigated the long-term post-merger financial performance and found a negative relationship between operational efficiency and deal size, and a positive relationship with the friendly nature of the merger (Ramaswamy, Waegelein, 2003). Firms acquiring rather big firms have a more complicated time absorbing those firms and in efficiently resembling them into the acquirer firm’s operation. Firms with long-term compensation plans have more positive post-merger financial performance.

The results are also consistent with the findings of several studies based on data from companies in developed and emerging capital markets (Healy et al., 1992; Switzer, 1996; Powell, Stark, 2005; Pawaskar, 2001). The following factors were identified as factors that have a significant impact on the operational efficiency of transactions: the size of the transaction and the friendly orientation of M&A.

Due to the small number of observations in the sample, the existence of a certain amount of subjectivity in its formation and the limited information required to identify the factors of the effectiveness of M&A transactions make research not so complete and detailed. General focus was made on the operational efficiency of M&A transactions over a long time horizon, through studying the financial reporting of companies participating in the transaction. An improvement in the operating efficiency of companies does not mean an increase in its value in the long run.

As a rule, the leading role in mergers and acquisitions is played by more efficient companies that have the necessary resources to expand their business. integration into the structure of the buying company. This is partly due to both Roll's "theory of pride" and the high information barriers that prevent an objective assessment of the effectiveness of acquiring a particular business. Incomplete information about the deal also leads to the fact that a significant part of mergers and acquisitions is incorrectly assessed by the market.

Despite this, mergers and acquisitions, subject to a number of conditions, contribute to an increase in the performance of both individual industries and the economy as a whole due to the transfer of assets from less efficient to more efficient owners and corporate structures.

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