Conceptual paper

Impact of Merger and Acquisitions on Firms Financial Performance: A study on United States of America

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Abstract

This study is to identify the effect of mergers and acquisitions on financial performance of firms in United States of America. This research used panel data analysis with time span of 6 years before and after merger and acquisitions with sample size of 100 sample companies. Moreover, this study will observe the difference between the pre and post M&Q position of the company on the financial performance (return on equity, earning per share, net profit margin and sales growth) of the acquirer to investigate the effect of M&Q in the companies in United State of America. Paired T-test will be employed in this research to construct the pre – post comparison. Since it has noticed empirically, the mergers and acquisition impact profitability of the company and enlarge their market share. Moreover, these mergers and acquisitions improve the value of the stockholders’ through raising the demand dividends in the market stock. The study will help the shareholders or chief executive officer of the companies in deciding an option to join and do the merger and acquisition with other companies. Furthermore, this research will be significant to the growing of the sector by providing the strong literature and outcomes of merger and acquisition activities and become a reference in the future for companies that want to apply this merger and acquisition activity.

Key words: Financial Performance, Earning per Share, Return On Equity, Net Profit Margin, Sales growth, United States of America

1. Introduction

This study is conducted to examine the effect of merger and acquisitions on financial performance in the United States of America. Empirically few researches were done in different industries and different time periods to unfold the puzzled phenomena, they used different variables to measures
the financial performance, so the effect of merger and acquisitions can be identified indifferently but accurately. Empirical in past is done to identify the effect of mergers and acquisitions on financial performance in developing countries and developed countries such as Mboroto (2013) did research on Kenyan petroleum firms; Omah, Okolie and Durowoju (2013) conducted study on Nigerian Banking sector; Kouser (2011) have done study in Pakistan on banking sector; Gohlich (2012) conducted study of cooperative banking sector in Germany; Mahesh and Prasad (2012) conducted research on airline sector in India; Tang (2015) make a study on bank sector in Philippine; Dutescu, Ponorica and Stanila (2013) have done research on Romania on consumer goods and service market; Yonathan and Hermawan (2013) did research on banking sector in Indonesia; Kwaasi and Ubabuko, (2011) conducted research in Sweden on non-listed companies; Hagedoorn and Duysters (2000) make a study on technology sector on Netherland; Naba and Chen (2014) did on African banking sector; and lastly Khong et., al (2015) conducted study on Malaysian banking sector.

The primary purpose of merger and acquisition activity is to elevate the profitability growth of the company. But this growth strategy goes through certain issues such as miscommunication and employee turnover while being executed. Further with the failure of the activity can push the company into chaotic situation in aligning their goals and stand to lose their positive performance. Since merger and acquisition activities recently increase around the world, companies that are doing merger and activities exposing themselves to having failure on performance between two companies that cause from differences between management style and opinion. Through merger and acquisition activities, the non-interest expenses of the company increasing instead of helping the company to attain cost savings. Furthermore, it also can lead to unachievable result and objective without preparing effective strategy and open communication between stakeholders. Therefore these set of issues signifies the need of this research in the most matured and developed economy on globe.

This research is to identify the effect of mergers and acquisitions on financial performance. Hence, the objective related to this topic was included:

- To examine the impact of merger and acquisition on Net profit margin
- To examine the impact of merger and acquisition on return on equity
- To examine the impact of merger and acquisition on earning per share
- To examine the impact of merger and acquisition on sales growth

2. Literature Review

The definition of merger and acquisitions mostly cited by Manne (1965) the merger is defined as the collision of two business entities in order to achieve one common goal. Other than that, Copeland, Weston and Shastri (1983) stated a merger and acquisition is defined as two or more companies join together and forms into a single company. Furthermore, Okonkwo (2004) argued that the merger can be done through acquisitions where most of the assets of the acquired company will be owned by the acquirer and the shareholders of the company taken over will be paid (Naba and Chen 2014).

There are various theories that are used and relate to merger and acquisition phenomena. Financial synergy theories are one of the famous in the shelf. As stated by Bradley, Desai, and Kim (1988); Seth (1990); Maquiera, Megginson, and Nail (1998); Hubbard and Palia (1990) financial synergy theory stated that the value of the combined firm will increase, compared with the company's operating individually (Li and Pan, 2013). Moreover, this theory also emphasizes that merger and acquisition further enhance the efficiency of the company as well as the existence of value created through the synergistic effect of synergy management and even through the financial and operating (Wang and Moini, 2012). The second most appreciated theoretical work in the context is Hubris theory. According to Roll's (1986)Hubris theory define that the management of acquiring firms overvalued the potential ability of acquisitions targets, and because of that wrong decision were made (Shleifer and Vishny, 2003). Particularly, in hubris theory states that shareholders of Acquirer Company suffered a loss in terms of stock price, but the target firm will having opposite effect (Deo,
Furthermore, monopoly theory was used in this research, which emphasize merger activities are a medium that is designed and implemented to attain market power, plus it is one of the theories that stated bidder shareholders will gain benefits through merger activities (Trautwein,1990). In addition, there is a view that the increase in the market power of the firm can be achieved through mergers and acquisitions of companies since both bidders and targets will be able to request higher prices at the payment of their buyer or customers (Gohlich, 2012). Lastly, agency theory also owns a significant position in discussing the M&Q issues. Agency theory states that the high principle representatives the agent to do the work, which both of company owners and managers have different interest (Gohlich, 2012). According to Eisenhardt (1989) the cost might be increase which nothing to do with the interest of the owners, and might be reduce the shareholder wealth and will affect the financial performance (Gohlich, 2012).

Seeing to the empirical literature on the topic, some notable studies is high lightened; Mboroto (2012) makes a study to investigate the effect of mergers and acquisitions on the financial performance. This research was carried on with only 4 sample companies that doing merger and acquisition in the period of 2002-2012 in petroleum firms in Kenya. For this research, return on equity, return on asset, liquidity management, macroeconomics factors and management efficiency as the dependent variable. The result showed that in the era of post-merger / acquisition, ROA of standard size overall financial performance has a major impact of mergers and acquisitions activity. Jayaram (2014) makes a study which represents effect of mergers and acquisitions on financial performance under the context of corporate sector of select Tata Group companies in India. Two samples of Tata Group companies in India were taken for a period of six years from 2004-2010. In the meantime, the gross profit margin and net profit is used to measure the dependent variables such as profitability, while the current ratio and quick ratio is used to measure prosperity shareholders.

Paper provided by Abbas et al (2014) purpose to study the financial performance of banks in Pakistan after merger and acquisition, and this research took 10 sample of banks in Pakistan and this research emphasis on banking sector in Pakistan. Moreover, this data research was taken for 6 years, which is from 2006-2011. In this study, ratio analysis was used to determine the dependent variable such as profitability and efficiency, liquidity ratios and leverage, while the independent variables were pre and post-merger acquisitions. In additional, the findings of the study shows that there is no progress or development in the financial performance of banks in Pakistan after doing merger and acquisition activity. Even most banks show a decrease in the dependent variable such as efficiency, liquidity and profitability; however, some of the banks like the Dubai Banking Group LLC and HSBC Bank Middle East Limited having growth in their financial performance after mergers and acquisitions. In addition, the results of leverage and liquidity are not much advancement. The overall result for this study, it is conclude that mergers and acquisitions not perform proficiently in financial performance of banks in Pakistan (Abbas et al 2014).

Liargovas (2011) provide a study to investigate the impact of mergers and acquisitions on the performance of the Greek banking sector within the data collection from 1996-2004. This study use 26 Greek commercial banks, which 11 banks were connected in mergers and acquisitions event and 15 banks as non-merger. To relate the performance of Greek banking sector on merger and acquisitions, the researcher use operating performance methodology and event study to analyze returns derived from the stock prices. The findings of this research showed that a positive correlation occurred between cumulative average abnormal returns and stock prices before the announcement of the merger and acquisitions. In addition, the acquirer shareholder receives a positive change of cash deals, compared with stock deals before the announcement. The overall result, there is no impact of the bank’s merger and acquisition and does not create wealth. since research is to compare performance among banks connected in mergers and acquisitions event and non-merger banks, the results of the performance of the bank applying mergers and acquisitions are not so prominent compared with non-merger banks, and industrial banks in Greek is medium and have low market shares (Liargovas 2011).
Lai et al (2015) manage a research to mainly investigate the financial performance of Malaysia local banks during periods of pre-merger and post-merger, which used paired sample T-test, T-Value testing, financial ratio analysis and Data Envelopment Analysis to investigate the leverage, shareholder’s wealth, cost reduction profitability and liquidity as dependent variable. The data from this research collected within 1999-2001 for pre-merger and 2002-2010 for post-merger period. The findings of this research showed that bank efficiency, productivity level, financial performance and even cost saving management have no notable development after merger acquisition activities done. Through the result 0.05 of T-test and paired sample t-value, it showed that no development in Malaysia Local banks for pre-merger and past merger. This is consistent with DEA approach result that almost of the banks have no changes after the merger and no positive development occurred (Lai et al., 2015).

Mahesh and Prasad (2012) provide a study to analysis the financial performance of 3 Indian Airline companies on the post-merger and acquisition, within 2005-2010 period of time. To determine the value of dependent variable which are interest coverage, dividend per share, net profit margin, earning per share and return on equity, paired sample t-test was taken. The researcher found that there are immaterial developments on dependent value on post-merger. other than that, the result from paired t-test state that between pre-merger and post-merger there are insignificant difference in financial performance of three Indian Airline companies since the value are greater than 0.01. Plus, the finding of this research accepts the null hypotheses which stated there are no developments in company's performance on pre-merger and post-merger activities (Mahesh and Prasad, 2012).

### Table 1: Key summary and variables

<table>
<thead>
<tr>
<th>Authors</th>
<th>Proposal (empirical/conceptual)</th>
<th>Measures/ variables</th>
</tr>
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<tbody>
<tr>
<td>Bhutta, R.M., Saad, M. and Tariq, T.A (2015).</td>
<td>empirical</td>
<td>-operating income margin&lt;br&gt;-net profit margin&lt;br&gt;-return to total asset&lt;br&gt;-return on equity&lt;br&gt;-return on investment</td>
</tr>
<tr>
<td>Kouser, R (2011).</td>
<td>empirical</td>
<td>-Gross Profit Margin&lt;br&gt;-Operating Profit Margin&lt;br&gt;-Net Profit Margin&lt;br&gt;-Return on Capital Employed&lt;br&gt;-Return on Net Worth&lt;br&gt;-Debt Equity Ratio</td>
</tr>
<tr>
<td>Joash, G.O (2015).</td>
<td>empirical</td>
<td>-Profitability&lt;br&gt;-efficiency&lt;br&gt;-liquidity ratios&lt;br&gt;-leverage</td>
</tr>
<tr>
<td>Abbas, Q., Hunjra. A.L., Azam,</td>
<td>empirical</td>
<td>-Merger and Acquisition</td>
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For this research, four (4) financial measures have been engaged to gauge the impact of merger and acquisition on financial performance. Empirical studies have been found with similar frameworks to gauge the impact of this growth strategy on the financial performance (Yonathan, and Hermawan, 2013; Ahmed and Ahmed, 2014; Wilkinson, 2013; Ugwuanyi, 2015; Cabanda and Pajara-Pascual, 2011; Yusuf, and Sheidu, 2015; Mboroto, 2013; Bhutta, Saad, and Tariq, 2015; Niranjan, 2015; Kouser and Saba, 2011; Mahesh and Prasad, 2012; Maranjian, 2009 and Raiyani, 2010).

Return on equity is a financial ratio that alludes to the amount of benefit an organization earned contrasted with the aggregate sum of shareholder equity contributed. Return on equity is the thing that the shareholders look consequently for their venture (Mboroto 2012). According to Mishkin, (2006) return on equity ratio shows how gainful an organization is by contrasting its net incomes with its normal shareholders’ value (Naba and Chen, 2014). The ratio measures how much the shareholders earned for their interest in the organization. Net profit margin can be defined as the whole total income the company generated from their sales revenue that includes all cost (Wilkinson, 2013). Moreover, instead of measuring the success of the company in gaining profit from their sales, net profit margin also used to measures company performance against its rivals within industry average, plus, used to identify the more profitable industries in different industries (Ugwuanyi, 2015). In order to measure the value of net profit margin, the total of net profit of the company will be divided with sales revenue (Yusuf and Sheidu, 2015). According to Maranjian (2009), when the companies having high margins, it reflects their strength. Malik (2004) stated that EPS is utilized to foresee future cash flows, for the differentiation of organizations' performance to set up the effect of issuing basic stocks (Joash, 2015). Other than that, EPS is used to measure the performance of each company as EPS relate to every shareholder's proportionate share in the organization's earnings. Other than to gauge a company's performance, basic EPS is valuable for contrasting an organization's current performance and its past record. Moreover, ROE shows how much amount profit is made per share, and is computed by isolating net income to the normal number of regular shares outstanding. Sales growth can be described as the increase of total average of sales in company's services or products usually from year to year (Batt, 2002). Sales growth also can be defined as the rate decrease or increase in deals between two time periods. As
stated by Brush et al. (2000), the company's performance will be great if the sales growth of the company is higher (Yonathan and Hermawan, 2013). Other than that, the higher sales growth rates make shareholder worth as long as the reinvestment of contributed capital is expected to acquire returns that surpass the company's cost of capital (Booth, 1998). Sales growth generally utilizes capacity more fully, which spreads settled expenses over more income resulting in higher productivity or profitability (Sam, Fazli and Hoshino, 2013).

Hypothesis Development:

H1: Merger and Acquisition positively influence Return on Equity.
H2: Merger and Acquisition positively influence Net Profit Margin.
H3: Merger and Acquisition positively influence Earning per share.
H4: Merger and Acquisition positively influence Sales growth.

Conceptual framework diagram

3. Methodology

The research design adapted for this study is descriptive explanatory which will help the study to test the designed hypothesis. Quantitative method is used to generalize the research by engaging sufficient number of sample size which is supported by the quantitative method. Secondary data collection will be done for this study from the published annual reports of the sample companies. Hence, 100 acquirers will be taken from United States of America as sample for this study through purposive sampling. While seeing to accessibility and reliability of the data, all the data will be collected from SEC audited annual report of the sample companies to ensure access and reliable data set. No severe ethical issues are entitled to the research due to secondary data though some legal issues such as legal access and copyrights of published data should be taken into consideration. Lastly, SPSS software will be used to analyze the collected dataset through descriptive mean analysis and Paired T-Test.

4. Conclusion
This research was conducted to study the effect of merger and acquisition on financial performance of firms registered United States of America. Based on Empirical literature, mergers and acquisition is found to increase their profitability and enlarge their market share. Moreover, these mergers and acquisitions improve the value of the stockholders’ through raising the demand dividends in the market stock. Hence, through engaging different theoretical approaches and empirical findings an efficient framework has been developed to gauge the impact of the growth phenomena on the financial performance of the companies in United States of America.

Reference


