

Mergers and Performance of Conglomerates Companies in Nigeria

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Abstract

Merger and acquisition among firms indicate the magnitude of economic gains that may arise depending upon the cultural fit between the merging firms. This study analyzed the effect of mergers and acquisition on performance of firms in Nigeria. Panel data for the study was collected on four sample companies for the period of fifteen years. Conglomerates companies were purposively selected for this study because they are the only sector on the Nigeria stock exchange list that has carried out merger and acquisition which covered the period of study (1990-2005). An analysis of the performance of the selected companies before and after the merger and acquisition transactions reveals that the post merger and acquisition transactions really improved the performance of sampled companies. This implies that the realization of merger and acquisition objectives such as optimization of resources, removal of duplication of operating cost and well coordinated management could be achieved.

Keywords: mergers, acquisition, firm's performance, conglomerates, quoted firms.

INTRODUCTION

There has been a growing trend throughout the world of companies merging and acquiring others. The main reason for companies to enter into such arrangement is to consolidate their power and control over governments and markets. While the acquiring firms have benefited from merger and acquisition transactions in some respects, there are negative and marginalizing aspects of merger and acquisition transactions some of which include imbalance distribution of benefit between acquired and acquiring firms. Conversely, for agency and Hubris theorist, such operations may destroy value.

In addition to the above issues, merger and acquisition professionals have pointed out that the magnitude of economic gains will depend largely upon the cultural fit between two combining firms. Further, they have argued that management of acquired firms should be retained after the completion of Merger and Acquisitions transaction because acquiring firms tend to regard knowledge of the management as a valuable asset. This study therefore attempts to analyze the effect of mergers and acquisition on performance of conglomerates. From this perspective, M&As are a way for managers to expand their empire, and thus, their remuneration or non-cash benefits, which often associated with the size of the firms managed. Furthermore, some managers may carryout M&As to entrench themselves in the firm. Even if such projects are not profitable from a financial perspective such managers invest in areas that make their specific skills indispensable in order to obtain higher remuneration

and to diminish the likelihood of being replaced (Shleifer and Vishny, 2000). According to the Hubris theory, too much confidence, pride and arrogance on the part of some decision-makers may lead them to overestimate synergistic gains and to place excess value on the target firm (Roll 1986, Hayward and Hambrick 1997).

The results of scientific studies on M&A tend to indicate that the lion's share of potential gains goes to the target rather than the acquiring firms (Jensen and Ruback 1983, Bhagot, Shleifer and Vishny, 1990 and Eckbo and Thorburn, 2000).

Yet, despite the growing increase in such events, relatively few researchers have looked into the investment returns to share holders of companies that have carried out mergers and acquisitions transactions. The results of U.S studies on the performance of M&As are contradictory specifically, studies by Doukas and Travlos (1988), Kang (1993), Markides and Ittner (1994) reveal that M&As generate significant announcement gains, but, according to Cakici et al (1996), Seth et al (2000) and Ecko and Thorburn (2007). This is not the case. These studies identify a few specific factors that shape this type of M&A: Increase of market share, Geographic Expansion, Vertical integration and conglomerate.

It would appear that research in this area is at an exploratory stage. There does not seem to be a clear consensus on what M&As may have on the wealth of the acquiring firm's shareholders or on key factors

determining the performance of such operations. Existing studies only cover the short-term impacts which this study notes as is shortcoming. M&As are very complex operations and their impact on acquiring firms will depend on a combination of factors which are very difficult to assess at the time of announcement this context, financial markets are only partially efficient.

Studies by Micheli and Stafford (2000) on evaluation of M&As are aimed at evaluating the extent to which the short-term losses or gains reported by financial markets when the M&A is announced are later maintained. In theory, the market value of these firms should not be seen to fluctuate abnormally considering their respective risk or compared to similar firms that have not carried out an M&A.

Several studies by Loderer and Martin (1992) have examined on evaluation of acquiring firms engaged in M&As. The returns are estimated with stock market data covering the three to five years after the M&A's announcement. The results obtained are contradictory. They tend to demonstrate that efficiency and synergistic gains are not always full realized. Agrawal, Jaffe and Mandelker (1992) suggest that acquiring firms sustain losses, while Loderer and Martin (1992), Lough ran and Vijh (1997) and Mitchell and Stafford (2000) obtain virtually no abnormal returns. Furthermore, Franks, Harris and Titman (1991) and Rau and Vermaelen (1998) obtain different results depending on the methodologies used or the subsets considered.

In Nigeria, many quoted firms have implemented M&A transactions or plan to engage in such transactions because this method is known to be cheaper and quicker than others such as internal development or strategic alliance for achieving growth. However, empirical research findings drawn from other fields other than quoted firms' research do not provide solid guidance whether quoted firms should seek M&A transaction that is some studies have reported that M&A transactions weakened the position of a firm in the competitive market, while others have indicated that M&A generated significant economic returns (Olowe, 1998)

Further, in a more narrow perspective, no consensus has been reached regarding whether firms should acquire related or unrelated businesses. The transactions of mergers and acquisitions in the quoted firms, as in other firms, increased dramatically during the 1990s till present. However, little research has been reported on the phenomenon of M&A transactions given the tremendous number and the value of such transactions. The research that does exist is extremely prescriptive or theoretical rather than descriptive. It is hope that this study will fill the gap and provide a systematic research that addresses

the prevailing phenomenon of M&A transactions in Nigeria.

Contemporary business organization seek to grow for business survival and such an assertion can be supported by Freier's (1990) empirical observation that "over the past twenty (20) years, the minimum company size required to compete successfully in most industry segments has been steadily increasing". Under the premise that growth is a vital element for business survival, a firm can grow and develop core competences either internally by investing in and nurturing within-firm resources or externally by acquiring another firm.

Corporate organizations need to expand in today's increasingly competitive and international business environment so as to achieve economies of scale in production, promotion and distribution. Mergers and acquisition is no doubt one way in which to obtain such drastic expansion or growth. In his book- "The corporate mergers", Albert and Joel, (1986) "One of the key stones of a free enterprises and prices determined economy (i.e. capitalism) is the strategy for entry". Every corporate entity in such an economy is faced with a problem of growth whether in output or profitability. In today's global business environment companies may have to grow to survive and one of the best ways to grow is by merging with another company or acquiring other companies. Growth may be achieved through internal or external entry into a new industry or market. While internal entry involves -increasing unit sales consistently and developing new products through research and development; External entry includes - Mergers and Acquisitions and strategic alliance.

A merger occurs when one firm assumes all the assets and all the liabilities of another firm. The acquiring firm retains it's identify, while the acquired firm ceases to exist. A majority vote of shareholders is generally required to approve a merger. A merger is just one types of acquisition. One company can acquire another company in several other ways, including purchasing some or all of the company's assets or buying up its outstanding shares of "stock. In general, mergers and acquisitions are performed in the hopes of realizing an economic gain. For such a transaction to be justified, the two firms involved must be worth more together than they were apart. Some of the potential advantages of mergers and acquisition include achieving economics of scale, combining complementary resources, garnering tax advantages and eliminating inefficiencies. Other reasons for considering growth through mergers and acquisitions include obtaining proprietary rights to products or services, increasing market power by purchasing competitors, shoring up weaknesses in key business areas, penetrating new geographic

regions or providing managers with new opportunities for career growth and advancement. When a small business owner chooses to merge with or sell out to another company, it is sometimes called "harvesting", the small business. In this situation, the transaction is intended to release the value locked up in the small business for the benefit of its owner and investors. The impetus for a small business owner to pursue a sale or merger may involve a need to diversify his or her investment, an inability to finance growth independently, or a simple need for change. In addition, some small businesses find that the best way to grow and compete against larger firms is to merge with or acquire other small businesses.

In general, acquisitions can be horizontal, vertical or conglomerate. A horizontal acquisition takes place between two firms in the same line of business. For example the acquisition of the Nigerian Soft Drinks Company us. Limited (NSDC)- bottlers of the Schweppes range of soft drinks by the Nigeria of Bottling company- bottlers of the coca-cola soft-drink. In contrast, a vertical merger entails expanding forward or backward in the chain of distribution, to towards the source of raw materials or towards the ultimate consumers. For example, an Auto parts manufacturer might purchase a retail auto part store. A conglomerate is formed through the combination of unrelated business.

Other types of combination of two companies are a consolidation. In consolidation, an entirely new firm is created, and two previous entities cease to exist. Consolidated financial statement are prepared under the assumptions that two or more corporate entities are in actuality only one.

Another way to acquire a firm is to buy the voting stock. This can be done by agreement of management or by tender offer. In a tender offer, the acquiring firm makes the offer to buy stock directly to the shareholders thereby by-passing management. In contrast to a merger, a stock acquisition requires no stockholder voting.

In principles, the decision to merge with or acquire another firm is a capital budgeting decision much like any other investment decisions. But mergers and acquisition differ from ordinary investment decisions in at least five ways.

First, the value of a merger and acquisition may depend on such things as strategies fits that are different to measure. Second, the accounting, tax and legal aspects of a merger can be complex. Third, mergers often involve issues of corporate control and are a means of replacing existing management. Fourth, mergers obviously affect the value of the firm, but they also affect the relative value of the

stocks and bonds. Finally, mergers are often "Unfriendly"(Averbach, 1988).

Prior to 1980's, Mergers and Acquisitions was an alien concept to the Nigeria business environment but not so anymore-Mergers and acquisitions have made their debut in some Nigerian business.

Nigeria's economic has been in recession for a number of years. Some companies have had significant reduction in capacity utilization due to the combine effect of lowering aggregate demand and the problems of supplies to meet production requirement (Akamiokahor, 1992).

Profit margins of the companies have also come under severe pressure. The deregulation of the economy is the best thing that has ever happened in this country since independence but it now means that companies have to compete for an increasing share of a decline market through pricing, improved product quality, improved services and other marketing mix. (Giwa, 1989)

The high cost of capital and the replacement cost of existing assets in the face of cash squeeze, towering profit margins and fierce competition means that the winners shall be companies with very able and efficient management with the right products portfolio and who recognizes all the dynamics in their business and the environment and must be capable of putting their fingers on all the critical Issues of today. These changes in the Nigerian business environment demand that adoption of Mergers and Acquisitions as growth for business organization. While firm seeks the external mode, the Mergers and Acquisitions transaction. The most critical concern will be whether the Merger and Acquisition transaction will create economic gains. This might relate to the type of business and corresponding performance to be purchased by a firm. That is the type of diversification should a firm choose in implementing a growth strategy. The type of diversification refers to the degree of business relatedness or fit between the acquiring and acquired firms.

METHODOLOGY

Data for the study was collected on four sample companies for the period of 15 years. Data were obtained from annual reports and statement of accounts of the sample companies. Conglomerates companies were purposively selected for this study because they are the only sector on the stock exchange list that has carried out merger and acquisition which covered the period of study (1990-2005). Variables used in this study include profitability performance measure by sales/turnovers, net profit, earnings per share, returns on capital employed, and market adjusted returns of securities.

Result and Discussion

Table 1 shows that net total assets (NTA) in relation to turnover, profit before tax, profit after tax and return on capital employed are strongly positive correlated to the tune of 0.975 (97.5%), 0.956 (95.6%), 0.960(96%) and 0.731 (73.1%) respectively. Conversely, net total assets in relation to profit margin and earnings per share shows a weak relationship of 0.456(45.6%) and 0.451(45.1%) respectively. Added to these, the p-value less than 0.09 and t-value greater than 2 support that there is a significant relationship between net total assets in relation to turnover, profit before tax, profit after tax return on capital employed and vice versa when net total assets is compared in relation to profit margin and earnings per share.

Table 1: Performance before merger and acquisition

Variables	R	T	p-value	Decision
NTA and turnover	0.975	8.855	0.001	Significant
NTA and profit	0.956	6.503	0.003	Significant
NTA and profit margin	0.960	6.834	0.002	Significant
NTA and profit after tax	0.456	1.028	0.362	Not significant
NTA after EPS	0.451	1.010	0.370	Not significant
NTA and ROCE	0.731	2.139	0.099	Not significant

Table 2 shows the result after merger and acquisition of conglomerates. The relationship between net total assets in relation to the turnover, profit before tax and profit after tax turn out to be significant with positive correlation to the tune of 0.886 (88.6%), 0.737 (73.7%) and 0.693 (69.3%) respectively being supported with the p-value of less than 0.026 and t-value of greater than 2 and vice versa when net total assets is compared in relation to profit margin, earning per share and return on capital employed.

Table 2: Performance after merger and acquisition

Variables	R	T	p-value	Decision
NTA and turnover	0.886	5.391	0.001	Significant
NTA and profit	0.737	3.082	0.015	Significant
NTA and profit margin	0.693	2.716	0.026	Significant
NTA and profit after tax	0.111	0.317	0.760	Not significant
NTA after EPS	0.283	0.835	0.428	Not significant
NTA and ROCE	0.407	1.280	0.243	Not significant

An analysis of the performance of the selected companies before after and combined results of the merger and acquisition transactions and their market return performance reveal that the post merger and acquisition transactions really improved the

performance of sampled companies. This implies that the realization of merger and acquisition objectives such as optimization of resources, removal of duplication of operating cost and well coordinated management could be achieved.

CONCLUSION

Merger and acquisition among firms show the magnitude of economic gains that will arise depending upon the cultural fit between the merging firms. Previous studies show that acquiring firms tend to regard knowledge of the management as a valuable asset. This study therefore attempts to analyze the effect of mergers and acquisition on performance of conglomerates. The result shows that after merger and acquisition of conglomerates, the relationship between net total assets in relation to the turnover, profit before tax and profit after tax turn out to be significant with positive correlation and vice versa when net total assets is compared in relation to profit margin, earning per share and return on capital employed. This leads to the conclusion that the realization of merger and acquisition objectives such as optimization of resources, removal of duplication of operating cost and well coordinated management could be achieved.

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