

Mega Mergers in Indian Aviation Industry

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ABSTRACT

Air transportation is a major industry which has seen many mega mergers in recent years involving billions of rupees. Mega mergers take place through acquisition, merger, consolidation and combinations of two existing players. It has been seen from the market trends that this is an era of "coopetition" not of competition and airline industry has also followed the same trend. The analysis here is focused on the various profound mergers and acquisitions that have taken place in the international aviation industry with special reference to Indian aviation market. Another objective is to quantitatively assess their financial position pre and post merger in terms of profitability and liquidity. It has been observed that some mergers and acquisitions resulted in the improvement of financial performance for the respective companies. Contrary to it, some companies were even declared bankrupt after operating for few years. So, it has also been found that these mergers do not guarantee success. The possible outcome can be positive or negative.

1. Introduction

The literal meaning of mega merger is a merger of two or more large corporations. The term Megamerger is used to depict the union of two or more large corporations, usually involving a business worth billions of dollars. A megamerger leads to a formation of a corporation that dominates or controls a large percentage of market shares within the respective industry.

Megamergers are achieved through acquisition, merger, consolidation or combination of two existing corporations and due to their scale it differs from traditional mergers. Companies attempting megamergers firstly tend to seek approval from both companies' board of directors and shareholders and are lately heavily scrutinized from government regulators. In INDIA, regulators that have jurisdiction over mergers in the aviation sector include the DGCA, MCA. The process for megamergers is very lengthy and cumbersome as in the U.S. it can stretch on for years.

Mergers & Acquisitions Overview

Merger: During a merger, the board of directors for the merging companies agrees to the union and ask for the shareholders' approval. After the merger, the acquired company cease its existence and becomes part of the acquiring company.

Acquisition: In a simple acquisition, the majority stake is obtained by the acquiring company in the acquired firm, which does not alter its name or legal structure.

Consolidation: On contrary to the Acquisition, a new company is created in consolidation. Approval of stockholders of both the companies is necessary, following which both of companies are given common equity shares in the new firm.

Why Merge?

All mergers and acquisitions not considering their category or structure, have one common goal: they are all aimed to create synergies that make the value of the united companies bigger than the sum of the two parts. This synergy decides the success of a merger or acquisition. Synergy comes in the shape of revenue enhancement and cost savings.

By merging, the companies look forward to to benefit from the following:

- **M&A are used by many companies to grow in size and** leapfrog their rivals. much rapid growth can be achieved by the companies through **M&A, which otherwise** can take years or decades to double the size of a company through organic growth.
- M&A are done by the companies in order to dominate their sectors. However, since the union of two behemoths would result in a potential domination, such a business would have to run the gauntlet of intense scrutiny from anti-competition watchdogs and regulatory authorities.
- M&A are also done by the companies for tax purposes, even though this may be an implicit rather than an explicit motive. For example, since the U.S. has the highest corporate tax rate in the world, some of the best-known American companies have resorted to corporate inversions in order to substantially reduce its tax bill, This technique involves a U.S. company buying a smaller foreign competitor and moving the merged entity's tax home overseas to a lower-tax jurisdiction.
- As every employee knows, mergers are associated with job losses. All the money is considered to be saved from dropping the number of staff members from accounting, marketing, and other departments. Even the former CEO is not excluded from the job cuts, which normally leaves with a compensation package.

- Mergers also turn into enhanced purchasing power to buy equipment or office supplies as a bigger company placing the orders can save more on costs—when placing big orders, companies have a greater capability to negotiate prices with their suppliers.
- In order to sustain competition, companies need to dwell on top of technological developments and their business applications. And this could be achieved by buying a smaller company with unique technologies.
- Companies acquire companies to reach new markets and nurture their revenues and earnings. A merger may lead to expansion of the associated companies' marketing and distribution, providing them new sales opportunities. A merger can also perk up a company's standing in the investment community as bigger firms are likely to have an easier time raising capital than smaller ones.

2. Literature Review

Ramaswamy and Waegelein (2003) examined the post-merger financial performance of firms. The data was collected for 162 merging firms that occurred during 1975-1990 in the United States. The focus of the study was to assess the financial position for a period of 5 years. Industry- adjusted operating cash flow returns on market value of assets was used as the method for measuring performance. It was found that there was positive relationship between post merger performance and long term incentive plans and negative relationship between post merger performance and relative target size. The results exhibited a significant increase of 12.7 per cent in firm performance after the merger had taken place.

Kumar (2009) examined the post-merger operating performance of 30 Indian companies. Only those companies were selected that underwent merger procedure during the period 1999-2002 in India. The purpose of the study was to identify whether any synergies are obtained after merger, if yes, which are those synergies. The analysis has been carried out by comparing pre-merger and post-merger data of merging firms. It was found that the post-merger profitability, assets turnover and solvency of the acquiring companies have shown no significant improvement when the figures are compared with pre merger data. It was observed that mergers do not always guarantee increase in the wealth of the concern. It has been suggested that managers of the merged firms should focus on post merger integration so as to create synergies.

Sinha et al. (2010) examined the impact of mergers and acquisitions on the financial efficiency of the Indian financial institutions. The data has been collected for the period 2000-2008. The data has been collected from secondary sources. Initially, ratios were calculated for assessing the profitability, liquidity, solvency, PBT and PBT/Income. After ratio analysis, Wilcoxon Signed rank test was used. It was found that there was significant improvement in all the parameters, representing that the mergers proved to be beneficial for the firms involved.

3. Objectives of the study

1. To determine influence of mergers on profitability standards of the surviving company.
2. To analyse liquidity position of the surviving firm after merger.

4. Scope of the study

This study is descriptive in nature. Here, we have thoroughly studied the major megamergers of Indian aviation industry. An effort has been made to compare the financial performance of merged companies two years before and two years after such megamerger. Case study methodology has been adopted and three major mergers have been studied.

5. Research methodology

Data Collection

For this study, secondary data has been collected through different articles, research papers and reports published about these mergers and acquisitions. Data on performance of selected companies for two years prior merger, the year of merger and two years after merger has been fetched from the PROWESS software.

6. Statistical tools & techniques

To analyze the data, Mean and standard deviation have been used. These operations have been carried on the data with the help of MS-Excel.

7. Financial data analysis

1. Air India Limited-Indian Airlines

The merger between Air India and Indian Airlines took place in the year 2007. So data has been collected for two years prior to the merger i.e. 2005, 2006 and two years post merger i.e. 2008, 2009.

	2005	2006	2007	2008	2009
Net profit margin (%)	0.39	0.24	0.24	-42.22	-42.2
Return on total assets (%)	-8.86	-22.84	-22.84	-15.94	-13.4
Quick ratio (times)	-74.55	-1153	-1153.14	0.1	0.07
Current ratio (times)	-4.05	-15.44	-15.44	0.12	0.09

Source: PROWESSIQ

The above ratios are indicative of the following facts:

1. Before 2007 (the year of merger), the net profit margin was merely 0.39% in 2005 which further decreased to 0.24% in 2006. Post merger, net profit

margin was negative, indicating losses to the concern and net loss ratio came out to be 42.2%.

2. ROTA was negative both in the pre merger period and post merger period. It was minimum in the year

2006 i.e. -22.84% and was maximum in the year 2005 i.e. -8.86%.

- Quick ratio indicating the short term liquidity improved post merger. It was negative in the year 2005, 2006 and became positive in the year 2008 amounting to 0.1 times, and further declined in the year 2009 to 0.07 times.

- Current ratio also significantly improved in the post merger period. It was -15.44 times in 2006 and improved to 0.12 in 2008. Like quick ratio, it also deteriorated in the year 2009 as compared with figures of 2008.

Test For Profitability

	MEAN		SD	
	PRE	POST	PRE	POST
Net profit margin	0.315	-42.21	0.11	0.01
Return on total assets	-15.85	-14.67	9.89	1.80

- As far as the mean values are concerned for the net profit margin, it is very much clear from the figures that the profitability has substantially reduced indicating that the merger has proved to be harmful for the profitability of the concern.
- The analysis for standard deviation reveals that there was more deviation in the profitability ratios in the pre merger period than the post merger years.

Test For Liquidity

	MEAN		SD	
	PRE	POST	PRE	POST
Quick ratio (times)	-613.85	0.085	762.68	0.02
Current ratio (times)	-9.745	0.105	8.05	0.02

- The average values for the liquidity ratios saw a significant change from being -613.85 times to 0.085 times in case of Quick Ratio and -9.745 times to 0.105 times in case of Current Ratio.
- The standard deviation represents that there was much higher deviation in the pre merger years than the post merger years which is merely 0.02 indicating very few variation.

2. KINGFISHER AIRLINES LIMITED - AIR DECCAN

The merger between Kingfisher airlines and Air Deccan took place in the year 2007. So, data has been collected for 2005, 2006 as pre merger years and 2008, 2009 as post merger years.

	2005	2006	2007	2008	2009
Net profit margin (%)	-30.8	-39.6	-15.62	-32.38	-29.98
Return on capital employed (%)	-84.87	-75.84	-19.76	-81.31	-42.22
Return on total assets (%)	-57.25	-52.68	-13.24	-40.32	-20.36
Quick ratio (times)	0.62	0.62	0.31	0.08	0.07
Current ratio (times)	0.71	0.66	0.35	0.1	0.09

Source: PROWESSIQ

From the above data, it can be observed:

- There was no major change in the net profit margin; it continued to remain negative moving around 30% approximately. It was highest in the year 2006.
- The figures indicate that Return on capital employed remained negative representing losses to the concern. It can be seen that the losses decreased in the year 2009.
- ROTA was also negative and it also turned favourable (however remained negative) in the year 2009.
- Quick Ratio has seen a positive change after the merger. Although a little betterment, but increased from 0.62 in 2005, 2006 to 0.08 in 2008 and declined to 0.07 in 2009.
- Contrary to the quick ratio, current ratio declined due to the merger as can be seen from the data. It was 0.71 and 0.66 in pre merger year and declined to 0.1 and 0.09 in post merger period.

Test for profitability

	MEAN		SD	
	PRE	POST	PRE	POST
Net profit margin	-35.2	-31.18	6.22	1.70
Return on capital employed	-80.355	-61.765	6.39	27.64
Return on total assets	-54.965	-30.34	3.23	14.11

1. Mean values in the above table indicate that there is improvement in the profitability of the concern due to merger although it continued to incur losses.
2. As far as standard deviation is concerned, there was stability in the net profit margin but more variations can be cited in return on capital employed and return on total assets.

Test for liquidity

	MEAN		SD	
	PRE	POST	PRE	POST
Quick ratio (times)	0.62	0.075	0.00	0.01
Current ratio (times)	0.685	0.095	0.04	0.01

1. Contrary to the profitability figures, liquidity indicators saw a negative change due to the merger move, both the quick ratio and current ratios declined substantially.
2. The quick ratio comparatively became more variable. However, current ratio represented less variation.

3. JET AIRWAYS-VISTARA

Etihad group purchased the stake in Jet airways in the year 2013. So, an effort has been made to assess the profitability and liquidity condition of Jet airways for two years prior to the deal and two years after the deal.

	2011	2012	2013	2014	2015
Net profit margin (%)	-9.55	-4.95	-21.28	-12.29	3.37
Return on capital employed (%)	-11.01	-7.68	-41.97	-32.74	10.01
Return on total assets (%)	-7.38	-4.51	-20.14	-12.93	3.75
Quick ratio (times)	0.15	0.17	0.14	0.2	0.23
Current ratio (times)	0.25	0.27	0.22	0.28	0.32

Source: PROWESSIQ

The figures given in the above table highlights the below mentioned facts:

1. The company faced losses even after the deal, but the position has improved. The losses transformed into an alluring figure for net profit margin for the year 2015.
2. Both return on capital employed and return on total assets were negative indicating losses. In 2014 i.e. the year after the deal, the losses reduced and ultimately converted to profits in the year 2015.
3. From liquidity point of view, the deal leads to a positive trend in both the quick ratio and current ratio.

Test for profitability

	MEAN		SD	
	PRE	POST	PRE	POST
Net profit margin	-7.25	-4.46	33.25	11.07
Return on capital employed	-9.345	-11.365	22.35	30.23
Return on total assets	-5.945	-4.59	22.03	11.79

1. It can be observed that financial position improved by taking net profit margin into consideration as the net losses declined. The same is the case with return on total assets. However, return on capital employed can be seen as not following the trend and it has shown a further decline.
2. On paying attention to the figures of standard deviation, there is comparative stability in all the three parameters.

Test for liquidity

	MEAN		SD	
	PRE	POST	PRE	POST
Quick ratio (times)	0.16	0.215	0.01	0.02
Current ratio (times)	0.26	0.3	0.01	0.03

- Both the quick ratio and current ratio improved in the post deal period when compared with the pre deal statistics.
- The standard deviation has exhibited that, there was more variation in the liquidity ratios after the deal took place.

8. Conclusion

It can be finely concluded that while mergers and acquisitions give the impression for constant growth in size and scope, but this does not always happen and even if they do happen, the results are not always sweet. For each deal that is

initiated, there are plenty that fall short to launch or fail to bloom. There are three main reasons for a merger or acquisition deal to fall short. The first being acquirer being deficient in funding to close the deal, second is the disparity in valuation estimates by the two parties and last but the most important government regulators' interference due to regulations. The empirical results are also evident of the same fact that in all the three cases mergers don't prove to be a boon. And this fact can be well supported with the present scenario where both Jet Airways and Air India are drowning in the sea of bankruptcy whereas Kingfisher has already been wound up.

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