IMPACTS OF MERGERS AND ACQUISITIONS ON COMPANY PERFORMANCE: EVIDENCE FROM NIGERIA.

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ABSTRACT

The history of Nigerian companies is replete with instances where companies have collapsed for reasons of inadequate capital base, ineffective management, operational inefficiency, low return on investment, fraud by top management, and low plant utilization. Today, organizations endeavour to find solutions to these problems by adopting survival strategies which predominantly involve mergers and acquisitions. It is necessary in the circumstance to find out the situation with Nigerian companies. The objective of this research is to examine the impact of mergers and acquisitions (M&As) on company performance in Nigeria. In carrying out this study, the merger of Total Nigeria Plc and ELF Oil Marketing Nigeria Ltd was selected as case study. The methodology adopted was using Altman's Z score model to affirm whether or not the strategy added value to the organizations. The finding of this study was that mergers and acquisitions tremendously improved the overall performances of the companies. The study concluded that mergers and acquisitions are appropriate and cheap platforms to "grow" companies and ensure their survival provided that the companies are in the same or related business.

Keywords: Mergers, Acquisitions, Performance, Impact.

INTRODUCTION

In the past forty years, Nigerian companies have suffered hash economic climate characterized by business failures, distress and low capacity utilization. In the circumstance, many of them have been considering Mergers and Acquisitions (M&AS) as means for achieving growth and survival (Adetunji, 1977).

Mergers and Acquisitions are a form of business integration and combination. A merger is a combination or integration of two or more existing companies with the combined company adopting the name of one of the companies or taking a completely new one. Pandey (2000) defines an acquisition as an act of acquiring effective control by one company over the assets ormanagement of another company.

Usually, in acquisition, there is an acquirer and an acquiree; the former being the firm acquiring while the latter being the acquired firm. The consideration for acquisition is either shares or cash. Where shares is the consideration, the acquirer issues its own shares in exchange for the acquiree's shares, while in the case of cash consideration, the offer is made, either from the acquirer's bank reserves or proceeds of the sales of shares issued specifically for that purpose. Often, the acquiree's shareholders are offered either of the two considerations or a mixture of both. Today, cases of mergers and acquisitions have increased tremendously in Nigeria.

The fact that the number of mergers and acquisitions is increasing in Nigeria is indicative of the fact that companies have found the need to adopt the strategies. Whether these strategies have been successful is yet to be proved. However, related literature reveals that there is conflicting evidence about the effectiveness of mergers and acquisitions.

In 2001, M& as total value worldwide topped $1,400 billion as more and more companies tried to boost profitability by sharing overheads. But many firms are failing at the first hurdle in the rush to exploit economies of scale. Seven out of ten mergers fail to improve shareholders value, and nearly a quarter of them actually destroyed it according to a survey by KPMG (Hayward 2002).

Proponents of Mergers and Acquisitions like Goldberg (1983) and Doz (1985) argued that merger and acquisition activity is essential for the development of strong global competitors and confers economic benefits on both parties concerned and the society as a whole. Whereas Constable (1986) and Stapleton (1989) argued that merger and acquisition activity confers littl e economic benefits.

The questions that now arise are: (i) Why were the mergers successful? (ii) What could be done to ensure mergers success? (iii) What is the impact of mergers and acquisitions on company performance? To answer these questions, the mergers of Total Nigeria Plc and ELF oil marketing Nigeria Plc was used as case study. The hypothesis of the study is "Mergers and Acquisitions donnot positively impacts on the performance of companies".

LITERATURE REVIEW

Why do Mergers and Acquisitions take place? Doz (1985) says that it is believed that Mergers and Acquisitions are strategic decisions leading to the maximization of a company's growth by enhancing its production and marketing operations. They have become popular in the recent times because of enhanced competition, breaking of trade barriers, free flow of capital across countries and globalization of business as a number of economies are being deregulated and integrated with one another. A number of reasons are attributed for the occurrence of Mergers and Acquisitions. These include:

i.   **Maintaining or Accelerating A Company's Growth**:- Growth is essential for sustaining the viability, dynamism and value-enhancing capacity of a company. A growth-oriented company may not able to attract the most talented executives but it would be able to retain them (Doz 1985).

      Mergers and Acquisitions may help to accelerate the pace of a company's growth in a convenient and inexpensive manner. Companies acquire production facilities as well as other resources from outside through Mergers and Acquisitions.

ii.   **Enhanced Profitability:-** The combination of two or more companies may result in more than the average profitability due to cost reduction and efficient utilization of resources. Pandey (2000) said that this may happen because of the reasons of Economies of scale, Operating economies and Synergy.

iii. **Globalization:-** The effects of globalization are evident in Nigeria where consolidation in few global industries particularly in the pharmaceutical sector have resulted in the merger of SmithKline Beecham and Sterling Health Products Ltd according to lyeigbuniwe (2004). The success of this example is an encouragement to local enterprises which have been considering merger and acquisition strategy as means for growth.

iv.   **Diversification of Risk:-** Richard (2005) says that diversification implies growth through the combination of firms in business. Such Mergers are called conglomerate Mergers. It results in reduction of total risk through substantial reduction of cyclical operations. Total risk will be reduced if the operations of the combining firms are negatively correlated. In practice, investors can reduce non-systemic risk (the company related risk) by diversifying their investment in shares of large number of companies.

v.   **Management Efficiency:-** There are always companies which profit could be improved upon by better operating and/or financial management. Such companies are natural merger targets for companies that have better management. As the Nigerian economy gets more competitive, some companies with poor management will fall on bad times and would become candidates for Mergers.

vi.   **Unused Tax Shields:-** The existence of unused tax shield is yet another inducement to acquire a company. When a company has tax loss carryover which it cannot use, it becomes an attractive acquisition candidate for a company that has enough taxable profits to utilize the tax shield and thereby reduce its tax liability and hence increase profits after tax according to Young (1989).

vii. **Surplus Cash:-** A different situation may be faced by a cash rich company. It may not have enough internal opportunities to invest its surplus cash and therefore it may either

distribute its surplus cash to its shareholders or use it to acquire some other company according to Young (1989). The shareholders may not really benefit much if surplus cash is returned to them since they would have to pay tax at ordinary income tax rate. Their wealth may increase through an increase in the market value of their shares if surplus cash is used to acquire another company.

viii. **Complementary Resources:-** Some companies acquire others to make better use of existing resources or to provide the missing ingredient for success. The target company may have a unique product but lack the engineering and marketing capabilities to produce and market it on a large scale. It is quicker and cheaper for such a company to merge with a company that already has ample engineering and marketing skills, rather than attempt to develop these skills from scratch. The two companies will be worth more together than apart because each acquires something it does not have and gets it cheaper than it would acting on its own according to Iyiegbuniwe (2004).

ix. **Unused Debt Capacity:-** Some companies do not use as much debt as they ought to. This creates unused debt capacity and could make such a company's debt capacity to generate increased earnings.

x. **Increased Market Power:-** Pandey (2000) says that a merger can increase the market share of a firm. The increased market share improves the profitability of the firm due to economies of scale. The merger activity limits competition and hence improves the market power of the company involved.

This study is based on theories that reflect on the impact of mergers and acquisitions on company performance in Nigeria. The differential efficiency theory states that if the management of firm A is more efficient than the management of firm B and after firm A acquired firm B, the efficiency of firm B is brought up to the level of firm A, then this increase in efficiency is attributable to the merger. Some firms operate below their potential and consequently have low efficiency. Such firms are likely to be acquired by other more efficient firms in the same industry (C&K Management Limited, 2003).

The strategic requirement that motivates mergers and acquisitions is to create synergy so as to build a competitive advantage position and finally improve the performance of the joined firms. It is apparent that organizational and human resource issues should received the level of attention that they deserve.

The following studies that were carried out on mergers and acquisitions are reviewed below. Antikainen (2002) carried out an evaluation of the success of mergers and acquisitions in Finnish Forest Companies. The objectives of the study were to find out what factors affected the success and how they would be measured. The findings showed that the companies

reached economies of scale in total costs and the profitability of the firms developed positively after the mergers. Consequently, shareholders got increased dividends.

Marimuthu (2008) carried out his research on the performance, financial characteristics and firm sustainability of mergers and acquisitions. The study examined the performance and financial characteristics of non-financial companies (low and high sales growth companies) that were involved in mergers and acquisitions in Malaysia.

Capital gain was used to measure the companies performances over two years. The study revealed that there is no significant difference in terms of performance between low and high sales growth companies.

Janicki (2002) examined the ways of measuring the success and failure of Mergers and acquisitions in the Automative industries and suggested that the market share growth after acquisition is the real measure of a successful organization.

The evaluation of the impact of mergers and acquisitions must involve the comparison between the pre-merger performance of the company and its post-merger performance. This exercise enhances the proper assessment of the impact. In this connection, a review of the various methods used by some researchers in this area of study is provided below.

Antikainen (2002) asserted that one way to ascertain the growth of companies in mergers and acquisitions is through traditional accounting based measures such as annual profits, return on equity (ROE), Earning per share (EPS), and market share prices.

Janicki (2002) advocated the use of market growth to gauge the success of mergers and acquisitions while Marimuthu (2008) evaluated the companies performances using capital Gains Yield based on their share prices over the period.

Juurmaa (1991) measured the value creation in acquisitions with the Operating Cashflow Return (OCF) on assets to discrible the company's capital utilization. The higher the ratio, the better the company used its capital resources.

Altman (1968) carried out studies on company failure and used a statistical technique that required the user to calculate five ratios each multiplied by a factor(weight) and then added together to produce a single score. The score known as the Z-Score is interpreted against a specific cut-off to indicate whether a company is on-going (successful) or likely to fail. The Z-score is considered most appropriate for this study because it combined several evaluation criteria put into one score. Details of this are contained in the methodology.

DATA AND METHODOLOGY

This study was designed to assess the contribution of Mergers and Acquisitions to the successful performance of companies in Nigeria. The Altman's (1968) model z-score was used to value the performance of the companies annually. To this end, the pre-merger performances were compared with their post-merger performances so that appropriate conclusions were made about whether the strategies have been effective in achieving their objectives. Total Nigeria Plc was selected purposively for this exercise. A five year pre-merger period and another five year post- merger period were considered

The data for this study was secondary data collected from published annual financial accounts.

Total Nigeria Plc acquired Elf Marketing Nigeria Ltd in January 2003. Therefore, the relevant published annual accounts for analysis are:-

i.   Total Nigeria Plc   -   1998 to 2007
ii. Eif Marketing Nigeria Plc   -   1998 to 2002

The analysis of data for this study involved the presentation of tables, and bar charts basedon the Altman's Z score model statistical tool (Brealey and Myers, 1996). This is given as:-

$$Z = 1.2\,x_1 + 1.4x_2 + 3.3x_3 + 0.6x_4 + 1.0x_5$$

Where

Z = Score index of company performance

$$X_1 = \frac{\text{working capital}}{\text{Total assets}}$$

Measures liquid asserts in relation to the size of the company.

$$X_2 = \frac{\text{Retained Earnings}}{\text{Total assets}}$$

Measures profitability that reflects the company's age and earning power.

$$X_3 = \frac{\text{Earnings before interest and tax}}{\text{Total assets}}$$

Measures operating efficiency apart from tax and leveraging factors. It recognizes operating earnings as being important to long time viability.

$$X_4 = \frac{\text{Market value of equity}}{\text{Book Value of Total debts.}}$$

Adds market dimension that can shore up security price fluctuation as a possible red flag.

X5 = $\dfrac{\text{sales}}{\text{Total assets}}$

Measures the utilization of assets to generate sales. It is the standard measure for sales turnover.

The decision rule here is that if the Z score in any year exceeds that of the preceding year, then there was an improvement in performance and vice-versa.

By simple observation of the results obtained from the above analysis, it would be possible to accept or reject the null hypothesis that the merger was not beneficial.

RESULTS

Total Nigeria Plc went into a merger with ELF marketing Nigeria Plc in January 2003 and the surviving company continued operations as Total Nigeria Plc till date. The performances of Total Nigeria Plc from 1998 to 2007 as well as that of Elf Marketing Nigeria Plc from 1998 to 2002 are presented and analyzed in figures below:

Table I: - Performance of Total Nigeria Plc

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year	Total Asset ₦ million	Sales ₦ million	Working capital ₦ million	Retained earning ₦ million	Earning before interest and tax ₦ million	Market share price ₦	Total market value of equity ₦-million	Book value of debts. ₦ million
1998	13,824	20,181	1,440	1,520	3,352	130	26,500	3,012
1999	14232	30,173	1,785	1,738	5334	132	38,913	3,034
2001	2073	40,272	1,804	2,915	7305	135	59,006	4,500
2002	29533	50,277	2,415	3,755	10,005	138	64,521	3,201
2003	70601	94,252	3.001	4,460	18,803	140	100,604	4,432
2004	95,322	87,845	4,914	6,724	37,719	155	140,412	5,229
2005	100,104	275,763	5,147	8,211	52,269	168	153,264	5,615
2006	143,447	317,426	5,870	10,735	74,235	186	160,041	6,470
2007	274,238	335,019	6,973	12,571	85,641439	200	163,763	7,121

Source: Derived from Published Accounts of Total Nigeria Plc 1998-2007

TABLE II:- Performance of Elf marketing Nigeria Plc.

year	Total Assets ₦ million	Sales ₦ million	Working capital ₦ million	Retained Earning ₦ million	Earning before interest and tax ₦million	Market share price ₦	Total market value of equity ₦ million	Book value of debts ₦ million
1998	15,143	25,521	818	1,190	1948	12	3478	1,586
1999	16,885	27,389	1,009	1246	2810	13	4719	2,437
2000	18,730	38,014	1,329	1748	3,852	15	6904	3,561
2001	20,149	42,507	1,482	2075	4,147	17	8715	4,100
2002	25,351	48,613	1,704	2,346	3,970	18	9,000	4,414

Source: Derived from published Annual Accounts of Elf marketing Nigeria Plc 1998- 2002.

TABLE III: - Z scores of Total Nigeria Plc

year	variables						
	$1.2x_1 +$	$1.4x_2 +$	$3.3x_3 +$	$0.6x_4 +$	$1.0x_5 +$	=	Z score
1998	0.13	0.15	0.80	5.28	1.46	=	7.82
1999	0.15	1.17	1.24	7.70	2.12	=	11.38
2000	1.04	0.20	1.16	7.87	1.94	=	12.21
2001	1.10	0.18	1.12	12.09	1.70	=	15.19
2002	0.05	0.09	0.88	13.62	1.33	=	15.97
2003	0.06	0.10	1.31	15.56	1.97	=	19.00
2004	0.06	0.11	1.72	15.00	1.95	=	18.84
2005	0.05	0.10	1.71	14.21	1.92	=	17.99
2006	0.04	0.09	1.51	13.48	1.69	=	16.81
2007	0.04	0.08	1.11	12.25	1.22	=	14.70

Source: Derived from Table I

TABLE IV: - Z scores of Elf marketing Nigeria Plc

year	variable						
	$1.2x_1 +$	$1.4x_2 +$	$3.3x_3 +$	$0.6x_4 +$	$1.0x_5$	=	Z score
1998	0.06	0.11	0.42	1.32	1.69	=	3.60
1999	0.07	0.10	0.55	1.16	1.62	=	3.50
2000	0.09	0.13	0.68	1.16	2.03	=	4.09
2001	0.09	0.14	0.68	1.28	2.11	=	4.30
2002	0.08	0.11	0.52	1.15	1.92	=	3.78

Source: Derived from Table II

Figure 1: - Performance Evaluation of Total Nigeria Plc Using the Altman's model

□ Pre-Merger Performance of Total Nigeria Plc
▤ Pre-Merger Performance of EIF market Nig. Plc
▦ Post-Merger Performance of Total Nigeria Plc
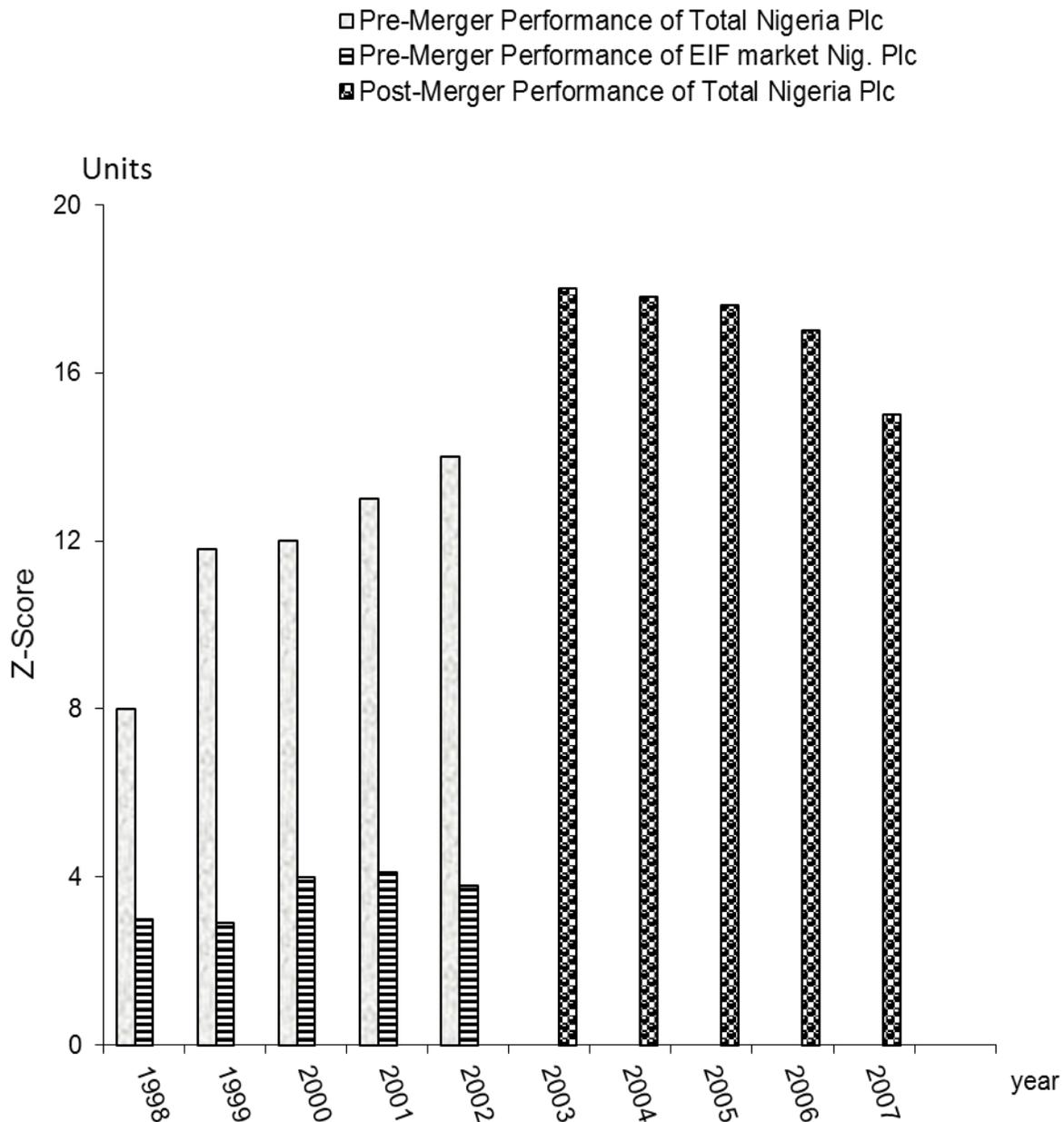
Source: Derived from Table III & IV

The evaluation of the performances of Total Nigeria Plc in the relevant years as disclosed above showed that its Z- score maintained a steady growth from 7.82 in 1998 to 15.97 in 2002 before the merger. However, after the merger, it made a remarkable performance of 19.00 in 2003 which was the highest during the period of review. Although this peak performance was never exceeded, its post merger performance was indeed better than those of the pre-merger years for both companies except for 2007 when it recorded 14.70. This development was due largely to increase in cost of sales which is explained by increase in personnel costs and operational expenses. On the whole, the merger activity by Total Nigeria Plc was a success story and was of great benefits to the development and growth of the company today.

Total Nigeria Plc is easily the most successful company in the downstream sector of the Oil and Gas Industry in Nigeria and its 50k shares are today selling for ₦ 250 per share at the Nigeria Stock Exchange (NSE).

CONCLUDING COMMENTS

The findings of this study were that Mergers and Acquisitions can enhance the performances of companies and facilitate corporate growth. Hence, they provide a lot of benefits to the parties involved in the process and the entire society.

The conclusion of this research is that Mergers and Acquisitions provide cheap and appropriate platforms to grow companies and they are viable tools of combating corporate decay.

Accordingly, the following recommendations are made:

i). In any Acquisition or Merger, it is important to estimate the cash flows that are incremental to the acquisition, since only such cash flow would add value to the acquiring company.

ii). There should be adequate professional investigations/due diligence prior to any acquisition.

iii). In evaluating a target company for merger and acquisition, it is necessary to take account of two key criteria-the level of business affinity and the level of business attractiveness. There is a higher probability of success if management remains with the type of business that they know and thoroughly understand. The level of market share is of considerable importance since high market share can create a virtuous cycle leading to higher profits, greater investment, lower unit cost, and yet greater market share.

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