

Conference Paper

Financial Performance Analysis of Companies With Merger and Acquisition Deals

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Abstract

This study was conducted to determine whether there are differences in the financial performances of companies before and after mergers and acquisitions. These companies are grouped into horizontal, vertical, and conglomerate mergers and acquisitions. The research was conducted on 104 companies with merger and acquisition deals in 2012–2015, of which 64 were classified into merger and acquisition groups, 23 were of the vertical mergers and acquisitions group, and 17 were of conglomerate mergers and acquisitions. On the basis of the research, it is revealed that almost none of the financial ratios of these companies show any significant differences in financial performance for either the whole company or the merger and acquisition groups. A significant difference of financial performance was only indicated by DERs for the horizontal mergers and acquisitions group before and after mergers and acquisitions.

Keywords: horizontal, vertical, conglomerate mergers and acquisitions, financial performance

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Received: 29 August 2018

Accepted: 18 September 2018

Published: 11 November 2018

Publishing services provided by
Knowledge E

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Selection and Peer-review under the responsibility of the ICOI-2018 Conference Committee.

1. Introduction

Mergers and acquisitions are takeovers that involve two firms; bidders (takeover companies) and target companies (taken over companies). Basically, bidder companies and/or targets have mergers and acquisitions as they are driven by certain motives, such as economic motives related to the creation of corporate value, synergy for extra income from the fusion of two or more companies, diversification motives, and non-economic motives. Ultimately, the purpose of all the motives for mergers and acquisitions is the survival of the company. Mergers are also intended to prevent companies from the risk of bankruptcy, which is the case when one or both of the companies that merge are experiencing financial difficulties. A merger protects the company from the risk of bankruptcy.

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After the hit of the economic crisis in 1998, there were four state banks that had a merge deal and they turned out to be quite successful; namely, Exim Bank, Bapindo, Bank Bumi Daya and Bank Dagang Negara, which merged with Bank Mandiri. To further strengthen its position, especially to disburse loans, Bank Mandiri acquired PT Tunas Financindo Sarana. In the end PT Tunas Financindo Sarana changed its name to PT Mandiri Tunas Finance.

However, Wiriastari (2010) concludes that there is no difference in the stock returns of the merging company before and after mergers and acquisitions. The stock return of the merged company before the merger and acquisition is the same as that afterward. This is mainly attributed to information leakage. Therefore, when the company had a merge and acquisition deal, the investors did not react to the shares of the company.

Another study conducted by Kemal (2011) on Royal Bank of Scotland (RBS) for four years (2006–2009) reveals that out of 20 (twenty) financial ratios used for analysis, there were only 6 (six) ratios that were either positive or better after the merger.

Liargovas and Repousis (2011), who studied the Greek banking sector, stated that there was no significant difference in the abnormal returns and financial performance of the Greek banking sector before and after mergers and acquisitions.

The current research is expected to support the previous research addressing the difference between companies' financial performances before and after mergers and acquisitions. The difference between this study and previous studies is that the group is merged based on economic activity classification that is horizontal merger, vertical merger and conglomeration merger. Horizontal mergers are those made between two or more companies that are engaged in the same industry. The purpose of a horizontal merger is to reduce competition or to increase efficiency through the incorporation of production, marketing and distribution activities, research and development and administrative facilities. Vertical mergers are those held by firms engaged in the same stages of the production or operation process. Such mergers are undertaken by companies intending to integrate their efforts with suppliers and/or users of products in order to stabilize supply and users. Meanwhile, the conglomeration merger is a merger between two or more companies engaging in unrelated industries. This merger is done because a company is attempting to diversify its business field into a completely different business field. If done continuously, the merger will form a conglomeration that has a very diverse business field.

1.1. Theoretical basis, empirical study, and hypotheses development

Mergers and acquisitions are a form of takeover. Companies or groups of shareholders who take the initiative to take over a company are called bidders and companies or groups of shareholders to be taken over are called targets. The takeover consists of two forms; namely friendly takeover and unfriendly takeover. Friendly takeover is a takeover based on agreement between both parties. Meanwhile, an unfriendly takeover is one that occurs when there is coercion or pressure from the bidder against the target.

Most companies decide to have merger and acquisition deals as they are driven by two fundamental motives; namely economic motives and non-economic motives. The economic motive relates to the company's goal, namely to increase shareholders' wealth. Meanwhile, non-economic motives are driven by the ambitious interests of the company owner or company management, instead of the interests of the company's goals.

Mergers and acquisitions may be classified by economic activity or by types of mergers and acquisitions. These are horizontal mergers and acquisitions, vertical mergers and acquisitions, and conglomerate mergers and acquisitions:

1. **Horizontal mergers and acquisitions** occur when two or more companies engaging in the same industry decide to merge. Horizontal mergers and acquisitions aim to reduce competition in the same industry and concentrate market structure in the same industry.
2. **Vertical mergers and acquisitions** occur when a company acquires another company of one link of production, that is, a company engaged in upstream to downstream production or vice versa. Vertical mergers and acquisitions aim to integrate business with suppliers and/or users of products in order to stabilize supply and users, and minimize the cost of supply in the production process.
3. **Mergers and acquisitions of merger conglomerates** occur when companies that are not in business or those unrelated to other companies either horizontally or vertically merge. Conglomerate mergers and acquisitions will form a conglomerate, which is to diversify the business into an industry or business that is different from the original business field.

1.2. Financial analysis

Financial analysis aims to find out the various important financial indicators of the company. Such an indicator will serve as a tool to know the financial condition of the company before and after the mergers and acquisitions of target companies and bidder companies.

One of the common tools used to analyze corporate finance is financial ratios. Company financial performance is viewed from the point of Liquidity, Solvency, Profitability, Activity and market performance. In this research the ratio used is: 1) to measure Liquidity: Current Ratio (CR); 2) to measure Solvency: Debt to Equity Ratio (DER), Debt to Assets (DTA); 3) to measure Profitability: Net Profit Margin (ROE), Return on Assets (ROA); 4) to measure Activity using Total Assets Turnover (TATO); and 5) to measure market performance using Price Earnings Ratio (PER).

Some previous researches related to the financial performance of companies have investigated whether mergers and acquisitions indicate different results. Research conducted by Khusniah (2012) states there is no significant difference in financial performance before and after mergers and acquisitions, after testing the companies during a two-year period before and a two-year period after mergers and acquisitions.

In a similar fashion, Liargovas and Repousis (2011) stated that there were no significant differences before and after the mergers and acquisitions in companies' financial performance in the Greek banking sector. The study also states that the financial performance of the Greek banking sector worsened after the merger and acquisition.

Based on the economic activity, a merger and acquisition can be grouped into several groups, namely: horizontal, vertical, and conglomerate mergers and acquisitions. Manurung (2011) states that horizontal mergers and acquisitions aim to reduce competition in the industry and concentrate market structure on the industry. Moin (2010) states that vertical mergers and acquisitions aim to integrate their efforts toward suppliers and/or users of products in order to stabilize supply and users to make it more efficient. Mergers and acquisitions of conglomerates are mergers or acquisitions of different industries aiming to diversify a company's business to form a conglomeration.

1.3. Development of hypotheses

This research is conducted not only to see the differences in corporate financial performance before and after mergers and acquisitions, but also to classify the merging and acquiring companies into horizontal mergers and acquisitions, vertical mergers and

acquisitions and conglomerate mergers and acquisitions. Differences in the financial performance of each group before and after the mergers and acquisitions are analyzed thoroughly. On that basis, this study proposes the following hypothesis:

H: There are differences in corporate financial performance before and after mergers and acquisitions for horizontal, vertical and conglomeration mergers and acquisitions

2. Research Methods

The population in this study is comprised of companies that conducted mergers and acquisitions during the period of 2012–2015 listed on the Indonesian Stock Exchange (BEI). The sample selection is done by identifying the respective bidder companies and targets meeting the following criteria:

1. Companies are listed on the Indonesian Stock Exchange 2012–2015.
2. The companies issued two full financial statements before and after the merger and acquisition.
3. The companies' business industry can be identified as horizontal, vertical or conglomeration merger.

This research uses secondary data taken from the database of the Indonesian Stock Exchange and from the Indonesian Capital Market Directory (ICMD).

3. Data Analysis and Discussion

In 2012–2015 there were 104 companies conducting deals of mergers and acquisitions, 64 of which are classified into horizontal groups, 23 of which are of vertical groups and 17 of which are conglomeration groups.

3.1. The impact of mergers and acquisitions on financial performance

Table 1 shows the financial performance of the company two years before and two years after mergers and acquisitions. It is obvious that only one ratio is the DER ratio showing the differences in financial performance before and after mergers and acquisitions. These results suggest that companies are increasingly effective in using their

TABLE 1: Different *T*-test of corporate financial performance of mergers and acquisitions.

| | Paired Differences | | t | df | Sig. (2-tailed) |
|-------------|--------------------|----------------|--------|-----|-----------------|
| | Mean | Std. Deviation | | | |
| Pair 1 NPM | 0.16750 | 0.66216 | 1.518 | 103 | 0.138 |
| Pair 2 ROA | 1.75500 | 11.88245 | 0.886 | 103 | 0.382 |
| Pair 3 ROE | 0.27750 | 33.29873 | 0.050 | 103 | 0.960 |
| Pair 4 CR | -0.08556 | 2.44760 | -0.210 | 103 | 0.835 |
| Pair 5 DER | 1.15389 | 3.26076 | 2.123 | 103 | 0.041 |
| Pair 6 DTA | 0.12111 | 0.39170 | 1.855 | 103 | 0.072 |
| Pair 7 TATO | -0.25917 | 0.97614 | -1.593 | 103 | 0.120 |
| Pair 8 PER | -22.74361 | 126.91743 | -1.075 | 103 | 0.290 |

equity to secure debt after mergers and acquisitions. Meanwhile, other performance ratios showed no significant differences before and after mergers and acquisitions. The results of this study support the research conducted by Khusniah (2012) and Purwono (2005).

The absence of a difference in the financial performance of companies before and after mergers and acquisitions might be due to the very short timeframe for measuring performance differences (only two years). Thus, it is impossible to see the synergies of companies that do mergers and acquisitions in the short term, because it requires a relatively longer period to see further impact on the company's competitive advantage.

3.2. The impact of mergers and horizontal acquisitions to the company's financial performance

Based on the test of companies of Horizontal Merger and Acquisition, it is revealed that of all the variables of financial performance used, only DER showed significant difference between that before and that after the merger and acquisition. In contrast, other financial performances – NPM, ROA, ROE, CR, DTA, TATO and PER – showed no significant difference between that before and that after mergers and acquisitions.

TABLE 2: T-test statistical significance on financial performance of companies with horizontal mergers and acquisitions.

| | Paired Differences | | t | df | Sig. (2-tailed) |
|-------------|--------------------|----------------|--------|----|-----------------|
| | Mean | Std. Deviation | | | |
| Pair 1 NPM | 0.04944 | 0.30396 | 0.690 | 63 | 0.499 |
| Pair 2 ROA | -0.77722 | 10.83985 | -0.304 | 63 | 0.765 |
| Pair 3 ROE | 4.30722 | 23.58927 | 0.775 | 63 | 0.449 |
| Pair 4 CR | -0.00111 | 2.32031 | -0.002 | 63 | 0.998 |
| Pair 5 DER | 1.63944 | 3.13224 | 2.221 | 63 | 0.040 |
| Pair 6 DTA | 0.19556 | 0.47594 | 1.743 | 63 | 0.099 |
| Pair 7 TATO | -0.50944 | 1.22705 | -1.761 | 63 | 0.096 |
| Pair 8 PER | -21.77056 | 93.50568 | -0.988 | 63 | 0.337 |

TABLE 3: T-test statistical significance of financial performance of vertical mergers and vertical acquisitions.

| | Paired Differences | | t | df | Sig. (2-tailed) |
|-------------|--------------------|----------------|--------|----|-----------------|
| | Mean | Std. Deviation | | | |
| Pair 1 NPM | 0.06909 | 0.18496 | 1.239 | 22 | 0.244 |
| Pair 2 ROA | 2.38818 | 10.53252 | 0.752 | 22 | 0.469 |
| Pair 3 ROE | -8.54636 | 38.97515 | -0.727 | 22 | 0.484 |
| Pair 4 CR | 0.56727 | 1.78174 | 1.056 | 22 | 0.316 |
| Pair 5 DER | 0.95455 | 3.94418 | 0.803 | 22 | 0.441 |
| Pair 6 DTA | 0.05000 | 0.30302 | 0.547 | 22 | 0.596 |
| Pair 7 TATO | -0.04818 | 0.34718 | -0.460 | 22 | 0.655 |
| Pair 8 PER | -55.42818 | 192.05158 | -0.957 | 22 | 0.361 |

3.3. The impact of vertical mergers and acquisitions on financial performance

The financial performance analysis of companies belonging to vertical mergers and acquisitions groups shows no significant difference for any financial performance ratios two years before and two years after the mergers and acquisitions.

The purpose of vertical mergers and acquisitions is to facilitate the production or operation process and minimize input costs in the production process to lower the selling price of the product. However, it is obvious that the concept of vertical mergers and acquisitions does not result in any significant difference in financial performance before and after mergers and acquisitions.

3.4. The impact of conglomerate mergers and acquisitions on financial performance

TABLE 4: *T*-tests statistical significance of financial performance of conglomerate mergers and acquisitions.

| | Paired Differences | | t | df | Sig. (z-tailed) |
|-------------|--------------------|----------------|--------|----|-----------------|
| | Mean | Std. Deviation | | | |
| Pair 1 NPM | 0.60857 | 1.40051 | 1.150 | 16 | 0.294 |
| Pair 2 ROA | 7.27143 | 15.82201 | 1.216 | 16 | 0.270 |
| Pair 3 ROE | 3.78143 | 46.40969 | 0.216 | 16 | 0.836 |
| Pair 4 CR | -1.32857 | 3.43445 | -1.023 | 16 | 0.346 |
| Pair 5 DER | 0.21857 | 2.54892 | 0.227 | 16 | 0.828 |
| Pair 6 DTA | 0.04143 | 0.25855 | 0.424 | 16 | 0.686 |
| Pair 7 TATO | 0.05286 | 0.84156 | 0.166 | 16 | 0.873 |
| Pair 8 PER | 26.11571 | 54.50989 | 1.268 | 16 | 0.252 |

The test for the financial performance of companies conducting conglomerate mergers and acquisitions indicates no significant difference for all ratios two years before and two years after mergers and acquisitions.

Conglomerate mergers and acquisitions aim to establish a business conglomerate. In addition, mergers and acquisitions of conglomerates can enlarge the company's assets. However, no significant differences in financial performances are shown before and after mergers and acquisitions.

Of all the different test results of companies classified into horizontal, vertical and conglomerate groups, there is no significant difference in financial performance two years before and two years after mergers and acquisitions except for DER horizontal groups and overall companies that show significant differences before and after mergers and acquisitions.

The absence of a difference in the financial performance of firms before and after mergers and acquisitions might be due to the short timeframe for measuring performance differences (only two years). It is impossible to see the synergies in companies doing mergers and acquisitions in the short term, as it requires a relatively longer period to see the further impact on the company's competitive advantage.

Based on the *T*-test statistical significance, overall these ratios do not depict significant differences in financial performance before and after mergers and acquisitions although the DER ratios show significant differences before and after mergers and acquisitions. Therefore, H1 in this study is rejected in accordance with the research by

Khusniah (2012); there is no difference in financial performance before and after mergers and acquisitions. However, overall there are no significant differences in financial performance before and after mergers and acquisitions.

The absence of significant differences in financial performance before and after mergers and acquisitions indicates that mergers and acquisitions after four years have not been able to achieve the desired financial synergies. This may be due to the period in which the human resources of the bidder companies are still adapting to the new organizational culture or related to the integration problem in the merger and acquisition company so that the financial performance after mergers and acquisitions has not reached the expected synergy.

The synergies expected from mergers and acquisitions cannot be seen in a relatively short time as the effect of merger and acquisition activities is a long-term achievement that will impact on the company's competitive advantage.

4. Conclusion and Recommendation

In general, mergers and acquisitions aim to obtain synergies or added value by joining two or more companies. The added value is commonly observable in the long rather than the short term. A study of the financial performance of 104 firms reveals that there was no significant difference in financial performance two years before and two years after mergers and acquisitions.

The company's financial performance of horizontal, vertical and conglomerate mergers and acquisitions also showed no significant difference before and after mergers and acquisitions. For the horizontal merger and acquisition, there is one financial performance, the DER, which shows a significant difference before and after merger and acquisition. Horizontal mergers and acquisitions are those of companies engaging in the same industry. Perhaps this is what makes companies more adaptable than vertical forms and conglomerates.

There are many factors leading to the failure of mergers and acquisitions. The factor of human resources also contributes significantly to the success of mergers and acquisitions. Different corporate cultures result in human resources being unable to adapt quickly to the conditions of the new company.

In order to see the synergies of mergers and acquisitions, it is expected that the next research should be conducted over a longer time span, not only two years after the merger or acquisition. It is recommended that the research be done for five years after mergers and acquisitions.

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