Financial Impact Of Cross Border Merger And Acquisition On IT Companies: With Special Reference To Infosys

Abstract

The present study seeks to empirically probe the financial impact of Cross border mergers and acquisitions on Indian IT Companies with special reference to Infosys Ltd. Ratio analysis and paired sample t test was done to measure the post and pre operating performance of the bidder firm. Result reveals that there is a difference in the operating performance of bidder firm after the acquisition. Cross border merger had a positive impact on some ratios but it also had a slight negative impact on some key ratios which could affect the profitability of the firm. However the overall performance has improved after the acquisition.

1. Introduction

Global oriented companies are searching for new markets to enter. Firms from developing countries are seeking partners to become globally competitive. Cross border deals happen when two companies from different countries merge together to face confronts together and to share risk uniformly. The watchword of globalization is ‘plaction’, that is plan and action together otherwise the other firm will harvest the profit (Beena Saraswathy).

Infosys is the second largest IT Company in India by revenue. Infosys had paid $58 million to acquire the Atlanta based McCamish system. Acquisition had taken place in the year 2009. McCamish system had suffered a sharp downfall of operating profit in the year 2008 and also faced a drop in market demand for their services. Infosys was seeking for a partner to expand...
globally and Infosys anticipated that the acquisition would position the Indian offshore giant as a local company in Atlanta. The reasons for acquisition differ for the bidder and the target firm. Fraser and Zhang 2009 have pointed out that the poorly performed US banks are the performed choice to get acquired by the Overseas Banks and this finding is consistent with the Infosys acquisition of McCamish system which was a poorly performed firm in Atlanta a city in US state of Georgia.

2. Literature Review

Previous works shows that there are two main approaches to study the impact of cross border merger and acquisition: Stock market based approach and the accounting based approach. Stock market based approach analyses the share market reaction of cross border merger and acquisition. The study is based on the assumption that stock market is efficient and could show the economic impact of the M&A’s (Selcuck 2008). Various studies argued that Cross border merger and acquisition had created a positive return for the involved firms (Rossi and Volpin 2003; Chari and Ouimet 2004; Liu 2007). These studies can be accurate only if the country is having a highly developed and efficient stock market like USA and UK. In India a study based on stock market may not reveal the accurate result and so the accounting based approach, where the financial impact can be arrived by using the accounting data of the involved companies will be more reliable and accurate.

3. Objective Of The Present Research

The objective of the present research is to identify whether there is a significant improvement in the pre and post operating performance of the bidder firms after the cross border deals.

4. Research Hypothesis

- **H₀** - (null hypothesis): financial performance of Infosys has not improved after the cross border merger and acquisition.
- **H₁** - (alternate hypothesis): financial performance of Infosys has improved after the cross border merger and acquisition.

5. Methodology

The present study adopts the ratio analysis and paired sample t test for a period of ‘5 years’ before and ‘5 years’ after the Infosys acquisition of Atlanta based McCamish System. Data were extracted from the Infosys web site. The samples are divided into two sub periods; ‘before and after 2009’ that is the year in which the Infosys had gone for overseas acquisition.

6. Empirical analysis

To assess the financial impact on bidder firm’s performance after the overseas acquisition the accounting approach is employed:

- **Return on Assets**: Return on Asset is defined as Net income/Total Asset
- **Return on Equity**: Return on Equity is defined as Net Profit/Equity Shareholder’s Funds
- **Profit Margin Ratio**: Profit Margin Ratio is defined as Net Income/Net Sales
- **Return on Capital Employed**: Return on Capital Employed is defined as Net Profit/Total Assets
- **Gross Profit Margin Ratio:** Gross Profit Margin Ratio is defined as Gross Profit/Net sales
- **Net Profit Margin:** Net Profit Margin is defined as Net Profit/Net Sales

### Table 6.1: Acquirer and Target Company

<table>
<thead>
<tr>
<th>Bidder firm</th>
<th>Target firm</th>
<th>Year of Merger</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infosys</td>
<td>Mc Camish Systems</td>
<td>2008-2009</td>
</tr>
</tbody>
</table>

### Table 6.2: Pre Mergers Financial Ratios of Infosys Ratios are in percentage

<table>
<thead>
<tr>
<th>Year</th>
<th>Return on Asset</th>
<th>Return on Equity</th>
<th>Profit Margin</th>
<th>Return on Capital Employed</th>
<th>Gross Profit Margin</th>
<th>Net Profit Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-2004</td>
<td>26.9</td>
<td>33.5</td>
<td>26.4</td>
<td>26.9</td>
<td>50</td>
<td>26.4</td>
</tr>
<tr>
<td>2004-2005</td>
<td>29.9</td>
<td>36.3</td>
<td>28.7</td>
<td>28.9</td>
<td>46.7</td>
<td>27.8</td>
</tr>
<tr>
<td>2005-2006</td>
<td>42.2</td>
<td>35.1</td>
<td>42.6</td>
<td>26.6</td>
<td>45.9</td>
<td>26.8</td>
</tr>
<tr>
<td>2006-2007</td>
<td>46</td>
<td>33.9</td>
<td>45.4</td>
<td>29.1</td>
<td>44.6</td>
<td>28.8</td>
</tr>
<tr>
<td>2007-2008</td>
<td>54.1</td>
<td>33.1</td>
<td>60</td>
<td>26</td>
<td>43.3</td>
<td>28.6</td>
</tr>
</tbody>
</table>

### Table 6.3: Post Mergers Financial Ratios of Infosys

**Ratios are in percentage**

<table>
<thead>
<tr>
<th>Year</th>
<th>Return on Asset</th>
<th>Return on Equity</th>
<th>Profit Margin</th>
<th>Return on Capital Employed</th>
<th>Gross Profit Margin</th>
<th>Net Profit Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-2010</td>
<td>60.7</td>
<td>27.2</td>
<td>74</td>
<td>22.6</td>
<td>47</td>
<td>27.6</td>
</tr>
<tr>
<td>2010-2011</td>
<td>67.4</td>
<td>26.3</td>
<td>77.2</td>
<td>21.7</td>
<td>54.7</td>
<td>24.9</td>
</tr>
<tr>
<td>2011-2012</td>
<td>27.5</td>
<td>26.6</td>
<td>24.7</td>
<td>27.5</td>
<td>105</td>
<td>24.7</td>
</tr>
<tr>
<td>2012-2013</td>
<td>26.7</td>
<td>24.8</td>
<td>23.4</td>
<td>26.7</td>
<td>106</td>
<td>23.4</td>
</tr>
<tr>
<td>2013-2014</td>
<td>26</td>
<td>24.2</td>
<td>23</td>
<td>26</td>
<td>106</td>
<td>23</td>
</tr>
</tbody>
</table>

To provide an insight in to the profitability of the company various profitability indicator ratios has been incorporated. ‘Return on Asset’ and ‘Return on equity’ has measured and the result indicated that there was an increase and then dent in the returns after the two years of merger. There is a substantial difference in the profit margin ratio of the acquired company in the two sub periods. Profit margin ratio suggests that the company had earned a considerable profit in the first two years of the acquisition but after the second year the earnings has showed a negative trend. Interestingly it has discovered that there is no substantial dissimilarity in the Return on capital employed ratio. Gross profit Margin had a further hike in the profit after the acquisition. The net profit margin has failed to sustain the upward performance after the acquisition.
Table 4: Analysis of Key Financial Ratios of Bidder Firm using the Paired Sample t test

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>SD</th>
<th>t-value</th>
<th>Sig</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PRE</td>
<td>POST</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on Asset (ROA)</td>
<td>39.82</td>
<td>41.66</td>
<td>11.33</td>
<td>20.58</td>
</tr>
<tr>
<td>Return on Equity (ROE)</td>
<td>34.38</td>
<td>25.82</td>
<td>1.31</td>
<td>1.26</td>
</tr>
<tr>
<td>Profit Margin Ratio</td>
<td>40.62</td>
<td>44.46</td>
<td>13.66</td>
<td>28.46</td>
</tr>
<tr>
<td>Gross Profit Margin</td>
<td>46.10</td>
<td>83.74</td>
<td>2.53</td>
<td>30.15</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>27.68</td>
<td>24.72</td>
<td>1.06</td>
<td>1.80</td>
</tr>
</tbody>
</table>

Significance level of t value is tested at a ‘significance level of 95%’ for all the ratios

The result above shows that some ratios have improved after the acquisition but not all. ‘Return on Assets’ has improved from 39.82 to 41.66 (10 year data) but t value suggest that the improvement is not statistically significant for a ‘significance level of 95%’. Cross border acquisition has dramatically decreased their ‘Return on Equity’ and the result is statistically significant with a high t value of 13.893. Profit margin ratio has also shown considerable improvement (40.62 to 44.46) however the result is not statistically significant with a t value of -.210. Gross profit margin has picked up the performance after the acquisition but not again significantly with a t statistics value of -2.603. ‘Net Profit Margin’ had dropped slightly after the acquisition and t value of 1.06 shows that the result is statistically significant.

The mean value of the table 4 is taken to gauge the pre-merger and post-merger performance of the bidder. Since most of the ratios have shown an improvement after the acquisition the alternative hypothesis is accepted that is the financial performance of Infosys has improved after the cross border merger and acquisition.
7. Conclusion

The present study has analyzed the difference between the pre and post financial performance of the bidder firm. The evidence discovered that the financial performance of the firm had improved after the overseas acquisition. The findings are inconsistent with (Francoeur 2007; Selcuk 2008; Chen and Lin 2009) studies which imply that cross border mergers will not improve the financial performance of the firms. However, the present study outcome is consistent with the Song and Kueh (2009) who have argued that cross border deals could increase the overall performance of the firm.

References