Impact of Acquisition on Operating Performance in Indian Pharmaceutical Industry

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Abstract

The present study demonstrates the effectiveness of strategies in pharmaceuticals for realizing the desired objectives. The impact of acquisitions on the operating performance, of these firms, with respect to the pre-acquisition and post-acquisition financial ratios is presented.

Keywords: Acquiring firm, Acquisitions and Operating Performance.

1. Introduction

Before 1990, Indian enterprises were subjected to strict control regimes, which led to random growth of Indian corporate enterprises. The Government reforms process initiated since 1991, influenced the functioning and governance of Indian enterprises, resulting in the adoption of different growth and expansion strategies by them. In that context, mergers and acquisitions (M&A) were adopted, though it was not a new concept in the Indian economy. In the past and present years, Indian corporate enterprises are refocusing on the lines of core competence, market share, global competitiveness and consolidation.

Foreign field competitors have further hastened the adoption of these processes. Indian corporate enterprises have adopted restructuring exercises through M&A to create an impact and for expansion of core areas of interest. The Indian corporate sector had experienced after 1991 similar augmentation by these strategies, mainly due to subsidiaries of large multinational companies [MNC] and to the augmentation by such strategies. Major sectors adopting these strategies include Finance, Drugs and Pharmaceutical, Telecommunication, Textiles, Electrical machinery and Tea.

1.1 Mergers and Acquisitions in India

Reorganising business entities by the practice of mergers and acquisitions has attained considerable significance. From 1991Indian industries has been exposed to multiple challenges nationally and internationally. The challenging competition by the international market compelled the Indian firms to use these vital option strategies.

The favourable factors, in the Indian context for the merger and acquisition deals are: dynamic government policies, corporate investments in industry, economic stability and experimental enthusiasm of Indian industrialists.

Table 1. *Trends in M&A's in The Indian Corporate Sector*

Year	Mergers	Acquisitions	Total
1975-90	425	117	542
1990-00	661	407	1068
1990-95	236	91	327
1995-00	425	316	741
2000-05	993	2332	3325
2005-09	774	2199	2973

In recent years, developing countries have probably adopted such strategies as Asian countries have witnessed since mid 1990 a considerable increase, similar to trends in the Indian corporate sector . There has been a substantial increase in the number of M&A in the Indian corporate sector in the post-liberalization period, particularly when compared with the earlier period of 1975-90, and shows a substantial the increase after the mid-1990s (Table 1). However, the pace, probably due to economic slowdown, retarded during 2005-2009.

1.2 Mergers and Acquisitions Trends in the Pharmaceutical Sector

Amongst developing nations the Indian Pharmaceutical Sector is currently the largest about to US$ 25 billion in 2010. Indian companies play a key role in this framework, driven by their superior biotech, drug synthesis skills of high quality and originality. There is a structural trend evolving worldwide, in pharmaceuticals, integrated manufacturing assets, differentiated business models and significant cost advantages.

Indian pharmaceutical companies exhibit supremacy compared to their multinational counterparts in India. Profit margins of Indian companies are on the rise; the recent trend of mergers and acquisitions by Indian pharmaceuticals are likely to provide a boost to the growth numbers. The total Indian Pharmaceutical Market is valued at US$ 8790 million with a growth rate of 8%. The market is predominantly a branded generic market, making the industry highly fragmented. with more than 20,000 domestic manufacturers of end-use pharmaceuticals, In the organized sector of the Indian Pharmaceutical industry there are about 250-300 companies, controlling about 70% of the total value output terms, with one third of the total market accounted for among the top10 players. The healthcare sector in India has experienced a paradigm shift, due to emerging trends in globalization, developing markets, industry dynamics, increasing regulatory and competitive pressures. Companies across the world are reaching out to their counterparts in an effort to take mutual advantage of core competencies in R&D, Manufacturing and Marketing and the concomitant opportunities offered by the changing global pharmaceutical environment.

The pharmaceutical sector offers an array of growth opportunities. This sector has always been dynamic in nature with the present rapid pace of change. To adapt to these changing trends, Tthe Indian pharmaceutical and biotechnology companies adapting to these evolved distinctive business models utilising the advantage of their inherent strengths and the "ever expanding nature' of this sector. These differentiated business models provide the companies with necessary competitive edge for consolidation and growth.

1.3 Mergers and Acquisitions in Global Pharmaceutical Sector

Since the year 2004 there has been an increase in the mergers and acquisitions in the global pharmaceutical sector. This was similar to the increase in the mergers and acquisitions in other industries, during the same period. There was 20% increase numerically, which stood at 1,808 transactions.. There were eight transactions with the value of more than $1 billion, numerically three more than 2003,the total finance of the deals being $112 billion showing an increase of 53%. However, these figures have not a study to analyze the growth profitability and operating performance of nine sample banks, during the pre and post merger period of five years. Using t- test, discriminant function analysis and multiple regressions, it was observed from the study that they include the acquisition of Aventis by Sanofi-Synthelabo, amounting to $60 billion. This is the largest acquisition in the pharmaceutical industry after the merger of Pharmacia and Pfizer in 2002.

Bharathi (2008) conducted performance of merged banks in respect of growth of total assets, revenue, profits ,investments and deposits witnessed a significant increase on the rate of in terms of profitability and operating efficiency of selected acquired banks. **Ashok panigrahi (2009)** carried out a study, on the challenge to the future of Indian M&A activities due to "global financial crisis"., presenting merger and acquisitions as an effective methods of corporate restricting and established it, as an integral part of the long-term business strategy of the corporate. The M&A activity impacts various diverse groups ,to name a few, like corporate management, shareholders and investors. The study has predicted that corporate India will continue to maintain its performance and pace, even with a slowing global economy.

2. Statement of the Problem

In the global market, number of companies among Indian pharmaceuticals, have entered into M&A agreements. These companies would be selling off Over-the-Counter the non-core business divisions.. This is expected to further consolidate the mid-tier of the pharmaceutical industry in Europe. Growth is always the priority of all companies involving expansion of business activities. Companies go for M&A for achieving higher profit and capturing expanding market share. M&A is the need of business enterprises for achieving economics of scale, growth, diversification, synergy, financial planning, Globalization of economy, and monopolistic approaches. These also create interest amongst companies for M&A for increasing their market power.

Research has to investigate further the impact of M&A on the operating performance of such firms of the Indian pharmaceuticals.

2.1 Objectives of the Study

To analyze the impact of M&A's on the operating performance of Indian pharmaceutical industry

2.2 Research Hypothesis

There is no significant effect on the operating performance of the companies after acquisition.

2.3 Methodology

The present study is mainly based on secondary data. The data was obtained from the annual reports relating to the various operating performances of Pharmaceutical sector firms, . The data has been augmented from websites, various books, journals and newspapers.

2.4 Period of the Study

The present study covers a period of six years,, spread over three years 2002-2003 before the date of M&A and three years 2009-2010 from date of M&A subsequently.

2.5 Sample Design

As the complete source list of all Pharmaceutical companies is not readily available, the data have been selected based on convenience sampling method. Table 2 shows the list of firms selected for the study.

Table 2. *List of companies used in the study*

S. No.	Acquirer company	Target company	Year
1	Ranbaxy laboratories Ltd	Terapia	2006

2	Sun Pharmaceutical Industries	Taro pharmaceutical	2007

3. Data Analysis and Tools Used

The data has been edited, classified and analyzed as per the norms of this study. Operating performance ratios, (pre & post-acquisition) were estimated during the period 2002-2003 to 2009 -2010, utilising tools appropriate to the objectives of this study (Table 3).

Table 3. *Operating Performance Ratio Of Indian Pharmaceutical Industry Merger Firms In Pre And Post-Merger Periods*

Year	OPERATING PROFIT RATIO				GROSS PROFIT RATIO			
	Ranbaxy laboratories ltd		Sun pharmaceutical industries		Ranbaxy Laboratories Ltd		Sun pharmaceutical industries	
	Pre-merger	Post-merger	Pre-merger	Post-merger	Pre-merger	Post-merger	Pre-merger	Post-merger
1	23.98	13.62	4.90	10.52	37.20	26.07	40.11	43.56
2	16.58	5.39	16.90	2.07	32.09	40.68	35.51	30.00
3	5.01	9.31	24.14	7.51	26.29	43.29	30.01	34.45
Mean	15.19	9.44	15.31	6.70	31.86	36.68	35.21	36.00
Sd	7.806	3.361	7.934	3.496	4.456	7.577	4.128	5.643
cv	0.513	0.356	0.518	0.521	0.139	0.206	0.117	0.156

3.1 Operating profit ratio

Table 3 displays the average operating profit ratio of selected merger firms. According to SD the variations in the operating profit ratio after merger was higher in case of Sun Pharmaceutical Industries (3.496) and lower in case of Ranbaxy laboratories ltd (3.361). According to CV the variations in the operating profit ratio after merger was higher in case of Sun Pharmaceutical Industries (0.521) and lower in case of Ranbaxy laboratories ltd (0.356).

3.2 Gross profit ratio

Table 4 shows higher average gross profit ratio of selected merger firms. According to SD the variations in the gross profit ratio after merger was higher in case of Ranbaxy laboratories ltd and lower in case of Sun Pharmaceutical Industries ltd. According to CV the variations in the operating profit ratio after merger was higher in case of Ranbaxy laboratories ltd and lower in case of Sun Pharmaceutical Industries ltd.

Table 4. *Profit ratio of selected merger firms.*

Year	Net profit ratio				Return on net worth ratio			
	Ranbaxy Laboratories Ltd		Sun pharmaceutical industries		Ranbaxy Laboratories Ltd		Sun pharmaceutical industries	
	Pre-merger	Post-merger	Pre-merger	Post-merger	Pre-merger	Post-merger	Pre-merger	Post-merger
1	20.72	11.72	34.23	14.44	39.32	17.28	31.58	31.64
2	13.81	-22.02	21.02	-29.50	35.07	25.80	32.19	40.69
3	5.78	14.33	8.92	24.34	36.07	29.78	32.31	42.49
Mean	13.43	1.34	21.39	3.09	36.82	24.28	32.02	38.27
SD	6.104	16.554	10.336	23.398	1.814	5.214	0.319	4.747
Cv	0.454	12.354	0.483	7.572	0.049	0.214	0.009	0.124

3.3 Net profit ratio

According to SD the variations in the net profit ratio post merger was higher in case of Sun Pharmaceutical Industries is 23.398 and lower in case of Ranbaxy laboratories ltd is 16.554. According to CV the variations in the net profit ratio after merger was higher in case of Ranbaxy laboratories ltd is 12.354 and lower in case of Sun pharmaceutical industries that is 7.572 (Table 4).

3.4 Return on net worth ratio

Table 4 shows the average return on net worth ratio of selected merger firms. According to SD the variations on net worth ratio post merger was higher in case of Ranbaxy laboratories ltd (5.214) and lower in case of Sun Pharmaceutical Industries ltd (4.747). CV variations in the return on net worth ratio after merger was higher in case of Ranbaxy Laboratories ltd is 0.214 and lower in case of Sun pharmaceutical industries that (0.124).

Table 5. *T-Test of Indian Pharmaceutical Industry Merger Firms In Pre And Post-Merger Periods*

S.no.	Company	Operating profit ratio (t-value)	Gross profit ratio (t-value)	Net profit ratio (t-value)	Return on net worth ratio (t-value)
1	Ranbaxy laboratories ltd	1.143	1.707	1.325	1.358
2	Sun Pharmaceutical Industries	-0.355	-0.818	-2.822	3.670*

(5% level of significance**)**

Table 5 reveals that for Ranbaxy laboratories ltd the‘t’ value is lesser-2.920, than the 5 per cent significant level. While the ‘t’ values are for, Operating Profit(1.143), Gross profit(1.707), Net profit(1.325) and Return on net worth(1.358).This leads to the acceptance of our hypothesis, proving that the company, after acquisition has no effect on their operating performance.

On the other hand the‘t’ value for Return on net worth ratio (3.670*) of Sun Pharmaceutical Industries is greater than the table value (2.353) at 5 per cent significant level of confidence. Hence, the hypothesis is rejected in this case and it has a significant effect on operating performance after acquisition of the company. In other cases, Operating profit ratio (-0.355), Gross profit ratio (-0.818) and Net profit ratio (-2.822) is not rejected. Thus, there is no significant effect on operating performance after acquisition of the company.

4. Suggestions

Sun pharmaceutical industries should improve the profitability, which indicate that the operating cost of these companies is higher. So, these companies should try to control such expenses. Ranbaxy laboratories ltd should improve net profit for firm’s wealth. Sun pharmaceutical industries should improve the net income for shareholders wealth.

5. Conclusion

The result and analysis of the key financial ratios of the acquiring firms shows that there is no significant effect on the operating of the firms following acquisitions. The operating performance of Sun pharmaceutical was better compared to Ranbaxy laboratories ltd., though the Ranbaxy laboratories ltd operating profit was not satisfactory.

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