The Impact of Acquisition on Financial Performance: The Case of Manufacturing Companies in Indonesia

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ABSTRACT

The purpose of this research is to examine the impact of acquisition on financial performance of manufacturing companies in Indonesia. The study uses manufacturing companies listed in the Indonesia Stock Exchange from 2010-2013 as the samples. While, variables used in this research are financial ratios including liquidity ratio, activity ratio, leverage ratio, and profitability ratio. The financial performance is analyzed using financial ratios consists of liquidity ratio, activity ratio, leverage ratio, and profitability ratio. To find out the relationship between the variables paired t-test analysis is applied. Finally, the financial ratio analysis result shows that there is no significant difference between one year before and after acquisition, only quick ratio that undergoes significant change. From the result it could be assumed that acquisition generally don’t significantly influence the financial performance of the acquirer company with financial ratio by proxy. This could happen because there might be weak strategies and the lack of experiences in doing acquisition.

Keyword: Acquisition, Financial Performance of Company, Financial Ratio

Introduction

The impact of globalization and free trade has caused business competition much tighter. This condition requires companies to constantly develop appropriate strategies either in the short or long term, so that companies can keep their existence. Financial condition is often considered the single best measure of a firm’s competitive position and overall attractiveness to investor. Determining an organization’s financial strengths and weaknesses is essential to effectively formulating strategies. Thus, it is very necessary for companies to develop an appropriate strategy and increase their work performance.

Business combination is a viable strategy, in which two or more separated companies are merged into one entity (PSAK No. 22). In general, business combinations unify previously separate business entities. The prime objective of business combination is to increase profitability (Beams, 2012). As the firms ultimate strive is to produce economic value added for shareholders. In relation to this strategy, expansion has long been regarded as a proper goal of business entities. A business may choose to expand either internally (building its own facilities) or external (acquiring control of other firms in business combination). However, the firms often prefer external over internal expansion option.

Merger and acquisition are recognized as one of ways in creating developed and fully-maintained companies. Merger is a combination of two firms to establish a new
one, while an acquisition is known as the purchase of one firm by another, however there is no new enterprise formed (Hitt, 2002). Mergers, acquisitions, and takeovers have been a part of the corporation world for centuries. In today's dynamic financial environment, companies are often confronted with determinations concerning these actions - after all, the task of management is to maximize shareholder value. Through mergers and acquisitions, a company can develop a viable gain and ultimately increase shareholder value.

From time to time companies prefer external growth through merger and acquisition more than internal growth (Hitt, 2002). By doing so, the objective of business combining through merger and acquisition is synergizing. It is to amplify the whole company value through merger and acquisition. In addition, merger and acquisition can provide a lot of advantages for companies such as marketing capability, research, managerial skill, technology transfer, and efficiency in the form of lower cost of production (Hitt, 2002).

Generally, merger in Indonesia is conducted based on Act No. 1/1995 about Incorporated Company, Government Regulation No. 27/1998 about Merger, Consolidation and Company Acquisition, Government Regulation No. 28/1999 about Merger, Consolidation and Bank Acquisition and other related rules. For public company, merger is done based on the Bapepam Regulation No. IX. G.1 about Business Combination.

In Indonesia, merger has been commonly adopted strategy and becomes an appealing alternative strategy for many domestic or foreign companies. However, recent development make the strategy face challenges as the government as regulators or facilitator endorse private companies or public companies to strengthen itself in facing challenges of economic globalization in the world. The purpose of this recommendation is to strengthen the national economy through raising high competition among companies. Therefore, private companies or public companies need to unite their power to be able to compete with multinational companies. As it is impossible to ban or forbid world companies to operate in Indonesia for any reasons.

The current most obvious example of encouragement from Indonesia Bank is the presence of policy for national banks to merge themselves to increase efficiency and strength in capitalization so that they have strong competitive power in the international level. Having the same purpose, the encouragement is also given to other companies such as stock companies, insurances, etc.

Hopefully by doing merger and acquisition, financial performance of the merged company may growth. Financial ratio is an indicator of financial performance. Besides, merger and acquisition can give a lot of advantages to companies, such as the increase of product marketing, research, managerial capability, technology transfer, and the efficiency in form of lower cost of production.

It is expected that the advantages from merger and acquisition can provide competitive excellence which in turn is able to increase the company’s value and maximize prosperity of the owner and the stockholders. Furthermore, from the perspective of company investment, merger and acquisition may indirectly trigger the rising of stocks in stock markets. By combining some businesses, it is hoped that companies can increase market target, diversity of businesses, or increase vertical integration of existing operational activities.
Business Combination

According to IFRS No. 3, Business Combination is a transaction or other occurrence in which an acquirer obtains the control of one or more businesses. Transactions sometimes referred as ‘true combinations’ or ‘combinations of equals’ are also business combination as that term is used in this IFRS. The intended business in IFRS 3 is a group of activity and integrity asset which can be managed and aimed at giving return in foreign exchange, treasury economizing, and other economic benefits directly to investors, owners, members, or participants.

Based on Financial Accounting Standard Statement No. 22 (PSAK No. 22) paragraph 8, 1999, it states: “Business combination is the statement of two or more different companies becoming one economic entity because a company unites with other company or takes control of assets and other company’s operations.”

Meanwhile, according to Barker (2002, p. 1), a business combination occurs when two or more companies join under common control. The concept of control relates to the capacity to assign direct policies and managements. Traditionally, the control over a company could have been gained by acquiring a majority of the company’s outstanding voting stocks. However, the diversity of financial and operating arrangements employed in recent years also raises the possibility of maneuvering control with less majority ownership.

From the definitions above, it can be concluded that business combination is a business development or company expansion by uniting a company with one or more other companies to be one unity in economy.

Merger

A merger is defined as a combination of two companies to form a new one (Hitt, 2002). Furthermore, since it joins two companies into one, a company which does the merger will takes or buys all assets and liabilities of the other company. Therefore, the company which does the merger has at least 50% of the stocks and another company stops operating while the stock holders receive an amount of cash money or stocks in the new company (Brealey et al, 1996). Merger is one of the expansion strategy of company or restructuring of a company by joining two or more companies. In merger, there is only a company which is permitted to exist while the other companies are closed down without liquidation.

Acquisition

Acquisition is defined as a taking-over of a company by buying stocks or assets of the company. The company which is bought still exists (Brealey et al, 1996). Meanwhile Accounting Perspective in Acquisition in PSAK No. 22 paragraph 8 explains that acquisition is a type of business combination where the acquirer in one of the companies takes control of net assets and operation of the acquired company by giving certain assets, acknowledging an obligation, or taking assets outside. To put it simply, company acquisition could be meant as company’s taking-over in buying stocks of the majority companies so that the leader of the stock holders are present. In an acquisition case, both of the acquirer and acquiree are still one entity.

Motives of Merger and Acquisition

Fundamentally, there are two motives supporting a company to do merger and acquisition. Those motives are economic motives and non-economic. Economic motive
is related to the essence of the company’s goal that is to improve the company value or to maximize the prosperity of stockholders. Non-economical motive is a motive which is not based on the company’s goal but on the subjective willingness or ambition of the owner or the company management.

**Accounting Methods for Merger and Acquisition in Indonesia**

Accounting methods for merger and acquisition in Indonesia has been arranged in PSAK No. 22 (IAI, 2009). The regulation defines ownership unity and purchase methods. However, in 2010, PSAK No. 22 has been revised with some necessary changes and supported by new standard in accounting. Thus, the method of ownership unity can only be applied in business combination involving entity control (PSAK No. 38). Acquisition method in Indonesia according to PSAK 22 is only purchase and adoption methods in IFRS 3 “Business Combination” which is effective on January 2011.

Financial Accounting Standard Statement (PSAK) No. 22 is prescribed to manage the accounting behavior in business combination. This Statement regulates the acquisition of a company by other company and also the merging of ownership (uniting or pooling of interest) if the acquirer cannot be identified. The acquisition accounting includes determining the cost of acquisition, allocating the cost of acquisition into the assets and the obligations from the acquired companies, and the account for goodwill emerged during and after acquisition. The other accounting problems related to the business merging are how to decide the numbers of minority ownerships, to calculate the sequence of acquisitions in one period, to change the cost of acquisition, to identify the assets and the obligations, and to include the necessary things.

According to Financial Accounting Standard Statement No. 22, the accounting behavior toward the business combination through acquisition is similar to the behavior during asset purchasing with normal market prices as a basis in joined values. The overtaken asset and obligations will be re-evaluated in acquisition date. This method will make the differences between the normal market prices and the net asset prices from take over companies for more apparent goodwill. Goodwill appears as a note effect of the related stocks on the side of asset with normal price which is higher than the price of the books. The amount of goodwill is exceeded than ‘the purchase consideration’ (the money paid to purchase the asset or business) over the total value of the assets and liabilities.

**Objectives of the research**

The main objectives of this study is is to examine the impact of acquisition on financial performance of manufacturing companies in Indonesia. To know the influences of acquisition on financial performance of company. To analyze whether there are differences of financial performance of manufacturing company before and after acquisition.

**Methodology**

A ratio analysis is carried out to analyze the impact of acquisition on financial performance of manufacturing companies in Indonesia. Secondary data form the period from 2010 to 2013 is used for the study. The financial ratios of the manufacturing company which is listed in Indonesia Stock Exchange before the acquisition and after
the acquisition are calculated and compared to reach the conclusions. These ratios are given as:

1. Liquidity Ratios
   a. Current ratio
   b. Quick ratio

2. Activity Ratios
   a. Fixed Asset Turnover
   b. Total Asset Turnover

3. Leverage Ratios
   a. Debt to Total Asset Ratio
   b. Debt to Equity Ratio

4. Profitability Ratios
   a. Operating Profit Margin
   b. Net Profit Margin
   c. Return to Total Asset
   d. Return on Equity

Literature Review
Several previous studies have conducted research regarding the impact of merger and acquisition decision of public company financial performance in Indonesia. The first study is Payamta and Setiawan (2004) research which indicates that there is no significant difference from period before and after merger and acquisition both in the form of share price and financial ratio aspect. Although, there are some financial ratios such as total asset turnover, fixed asset turnover, ROI and ROE that indicates significant difference in the period before and after merger and acquisition. But this result is only temporary and it is not consistent for a long term.

Furthermore, Hardiningsih (2007) on her study analyzed the long term impact on merger and acquisition towards financial performance of Acquirer Company and acquired company in Jakarta Stock Exchange. The financial performances in this study is measured by using financial ratios consisting of liquidity, activity, leverage, and profitability ratios, and stock return within a year, or one and two years before and after merger and acquisition. The result of this research shows that there is no difference of the whole financial ratios within a year before and after merger and acquisition on both Acquirer Company and acquired company. On the other hand, on stock return, Average Abnormal Return (AAR) of acquirer companies decreased significantly in time before and after merger and acquisition, whereas, there is no whole changes caused by merger and acquisition.

Furthermore, Sholicha (2011) conducted research on the impact merger and acquisition towards financial performance of Acquirer Company and acquired company. There are 11 acquirer company and 11 acquired company as samples. Financial performances is measured by using financial ratios consisting of liquidity, activity, leverage, and profitability ratios, and stock return within a year, or one and two years before and after merger and acquisition. The result shows that there is no difference of the whole financial ratios within a year before and after merger and acquisition on both Acquirer Company and acquired company. Moreover, based on the whole average score of financial ratios, acquier companies get higher score than that of acquired companies, because assets and obligations of the acquirer companies increase. Based on stock return, it shows that acquirer companies do not get any difference from
6 month before and after merger and acquisition because of the weak condition of Indonesia Stock Exchange at the current period.

Similarly, Aqie conducted (2013) research on the effect of merger and acquisition toward the abnormal return and financial performance in bidder firm at merger and acquisition announcement date to the registered companies in Indonesia Stock Exchange in 2009-2012. This study is aimed at observing whether merger and acquisition announcement affects the return stock and changes the company’s performance for stock bidder firm holders around the announcement date using test abnormal return (AR), cumulative abnormal return (CAR), and return on asset (ROA).

The analysis is used to discover the effect of the experiment test of Wilcoxon Signed Rank. Furthermore, Paired T-test was used to discover the difference in performance after and before merger and acquisition announcement. The samples are 32 registered companies in Indonesia Stock Exchange underwent merger and acquisition during 2009-2012 and 15 firms which reported the financial condition one year after and before the merger and acquisition announcement. The result of the t-test, Wilcoxon and Paired-T on abnormal return and return on asset shows that there is no market efficiency and financial performance. In this context, the accountants are expected to analyze deeper about the financial condition and the investors are expected to use the financial report wisely and make a right decision.

Hypothesis

Based on the previous studies, the hypothesis can be formulated as follows:

\( H_0: \) Acquisition has no effect to the financial performance of company.
\( H_a: \) Acquisition has an effect to the financial performance of company.

Results

The financial performance of the company is analyzed using liquidity ratios which analyzed the current ratio and quick ratio, activity ratios which analyzed the fixed asset turnover and total asset turnover ratios, Leverage Ratios which analyzed the debt to total asset ratio and debt to equity ratio, and the last profitability ratios which analyzed the operating profit margin, net profit margin, return on total asset and return on equity.

Revealing the performance one year before and after acquisition difference, the significance test is employed by using Paired Sample t-test and the significance level at 5%. The difference in financial performance can be seen from the difference in the financial ratios before and after acquisition. The result of the Paired Sample t-test over financial ratios before and after acquisition can be seen at Table 1.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Sign.</th>
<th>Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidity Ratios</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Ratio</td>
<td>0.343</td>
<td>Not Significant</td>
</tr>
<tr>
<td>Quick Ratio</td>
<td>0.011</td>
<td>Significant</td>
</tr>
<tr>
<td>Activity Ratio</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Asset Turnover Ratio</td>
<td>0.328</td>
<td>Not Significant</td>
</tr>
<tr>
<td>Total Asset Turnover Ratio</td>
<td>0.346</td>
<td>Not Significant</td>
</tr>
<tr>
<td>Leverage Ratios</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt to Total Asset Ratio</td>
<td>0.351</td>
<td>Not Significant</td>
</tr>
</tbody>
</table>
Debt to Equity Ratio  & 0.810 & Not Significant \\
Profitability Ratios &  \\
Operating Profit Margin Ratio  & 0.186 & Not Significant \\
Net Profit Margin Ratio  & 0.430 & Not Significant \\
Return on Total Asset Ratio  & 0.330 & Not Significant \\
Return on Equity Ratio  & 0.264 & Not Significant \\
(Source: Survey Results)

Findings

From the statistic result by using Paired Sample t-test, it shows average decreases and insignificant changes. From results, the values which are lower than 0.05, is only quick ratio that undergoes significant change at 0.011. These significance alterations in quick ratio caused by the joining two companies into one, the financial companies will indirectly increase. This would affect the quick ratio which sustains the significant result. The quick ratio change shows that the company is able to fulfill the short-term obligation without relying upon the sales of it inventories.

Whereas the other ratios such as current ratio, fixed asset turnover ratio, total asset turnover ratio, debt to total asset ratio, operating profit margin ratio, return to total asset ratio don’t show any significant changes. The insignificant differences might be caused by the incapability of the company in doing acquisition. There is no significant also indicates the failure of the company to meet the purpose of acquisition which are to reach a synergy; to save the operation produced by economical scale management, sales, production, or more effective and efficient distribution; to produce efficiency difference. This means that the management of the company is more efficient and the weak asset becomes more productive after acquisition; to increase the market domination and reduce the competition.

Furthermore, from economic side, the desired purpose to improve the company profitability post-acquisition has not been fully reached. One of factor is the incapability of the company to increase the sales and net profit after acquisition and the increase is nothing to compare with the cost of acquisition.

Even though there is no average improvement happened to the values of current ratio, quick ratio, fixed asset turnover ratio, total asset turnover ratio, debt to total asset ratio, operating profit margin ratio, return to total asset ratio, and return on equity ratio after acquisition, those differences are not significant enough to change the company’s performance, if it is analyzed wholly. It is only debt to equity ratio that shows the average increase toward the average value during the observed period.

This test result is different from the hypothesis proposed. The dissimilarity is expected because of the weak strategy and the lack of experience of the company acquirer in doing acquisition. The expected benefits from the acquisition are not reached optimally. Besides that, it may also be caused by the motive in doing acquisition. If it is to save the company from bankruptcy, especially for the companies who do acquisition. These companies would not get many profits because the companies acquired are dissolved legally and do not decide their own operational activities. These conditions caused the acquirer company do not obtain the expected results from the acquisition.

Based on the Paired Sample t-test result, it can be seen that the amount of average values of the financial ratios decline or there is no significant changes on the financial performance before and after acquisition. This shows that the motivation in
doing acquisition is more supported by other motivations, such as company diversification and business expansion for controlling the wider market share.

The total Paired Sample t-test result indicates that there are no significant differences or changes from the financial ratios of the company before and after acquisition. Furthermore, it can be inferred that the financial motivation of the acquisition is to improve the financial performance after acquisition cannot be realized. This may be caused by non-financial reasons such as a will to save the company from bankruptcy, or personal reasons from the owner of the company.

Conclusion

Based on the results and discussion on the effect of acquisition to the financial performance of a company, it can be concluded that the result the comparison between the financial performance of the company a year before and a year after acquisition shows that there is no significance difference or change from the financial ratio of the company before and after acquisition. The details of the results are presented as follow:

1. The average values of financial ratios have decreased and fail to give any positive effects on the financial performance to the acquirer company.
2. In terms of the diversification motives and other non-financial motives, it can be concluded that acquisition have reached its target.
3. The statistic test reveals that there is no different average value of financial ratio after and before acquisition. Thus, the first hypothesis is accepted.
4. It also revealed that non-financial motivation is more apparent to influence the decision to do acquisition, because there are some companies that are motivated to save the acquired company from bankruptcy, or for business diversification and expansion to control wider market share.

Limitation of The Research

Possible limitation of the research must be acknowledge when interpreting the result of this study. This research has several limitations in the following aspects:

1. The number of sample of companies studied is very limited. In Indonesia, acquisition are mostly done by go-public companies which join with non-go-public companies. The companies are not required to report the acquisition activity. Therefore, obtaining the company data is not easy.
2. The observation period of this research is only one year before and one year after acquisition. This duration might not be able to provide a valid company performance changes, because the company may need more time to adapt every changes caused by the acquisition both internally and externally.

Suggestion

Based on the research results of the impact of acquisition on financial performance: the case of manufacturing companies in Indonesia, hence the suggested advices are:

1. For Manager and companies
   For company owner and management, acquisition can be used as one of the way to maintain or improve the financial ratio of the company. Therefore the company can do acquisition as an alternative way or method to improve the financial performance of company.
2. For Investor
Investors are expected to be careful and analytical in assessing acquisition which will be realized by a company. Since business combination by acquisition does not always give a fine result both net profit and profitability of the company.

3. For the Next Researcher
   The future research similar to this research is expected to be able to lessen the limitation in this research. The next research might also be able to include new variables such as non-economical aspects which affect the company performance. Also, the length of the research can be extended so that the result represents the actual condition.

REFERENCES

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