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A Study on Consolidations in Indian Hotel Industry

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Abstract

Mergers and acquisitions around the world are now, not in favour of traditional viewpoint, that is, the power of linked up, reduced cost and enlarged scale of operations. M&A deals by the corporates around the world getting momentum to become bigger in size. All the sectors are participating in this move by having domestic and cross-boarder M&As. Indian hotel industry is also found aggressive in this move. So, it becomes imperative to know either they are serious towards value acquisitions or it is merely an image building process. In this context, the present study is based upon the performance appraisal of acquirer companies from this sector. The study is limited up to the five domestic mergers only, that have been took place from 1998-2008. It examines the financial performance of acquirer companies during the post-merger period by comparing it with pre-merger financial performance. Financial performance analysis has been conducted by considering the aspect of liquidity, profitability and solvency. This financial performance has been analyzed by controlling the financial parameters with industrial ratios to weed out the impact of other factors on the financial performance. At the market front, the response of stock market towards this corporate move is also examined by having a short-term as well as long-term analysis. The aforesaid analysis has been made by applying non-parametric Wilcoxon test for financial and GRANK test for market analysis. The study reveals no change in financial performance during post-merger period as well as at market front in short and long-term period.

Key words: Mergers, Hotel, Financial Performance, Stock market

Introduction

Hospitality industry of Indian economy has been coming up as one of the significant industry. It is acting as driving force for growth and development of service sector of the economy. Hotel and tourism industry is contributing 6.23% to National GDP, 8.78% employment in country and significant foreign exchange to the economy. Indian hospitality industry is following the path of functional growth, regular makeover and quality standards. India has

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ranked fourth most preferred travel destination by Lonely Plant by selecting the country among top five destinations from 167 countries. Hotel industry announces series of M&A during last few years. After the economic reforms of 1991, India has faced up the dare situations both at national and international level. This increased competition at international level motivated the Indian companies to opt for this route of M&As. Mergers and acquisitions around the world are now, not in favour of traditional viewpoint, that is, the power of linked up, reduced cost and enlarged scale of operations. M&A deals by the corporates around the world getting momentum to become bigger in size. All the sectors are participating in this move by having domestic and cross boarder M&As. Indian hotel industry is also found aggressive in this move. So, it becomes imperative to know either they are serious towards value acquisitions or it is merely a image building process. In this context, the present study is based upon the performance appraisal of acquirer companies from this sector. The study is limited up to the domestic mergers only. It examines the financial performance of acquirer companies during the post-merger period by comparing it with pre-merger financial performance. Financial performance analysis has been conducted by considering the aspect of liquidity, profitability and solvency. At the market front, the response of stock market towards this corporate move is also examined by having a short-term as well as long-term analysis.

Literature Review

A number of studies have been conducted on the topic of mergers and acquisitions. But there is no specific study on the hotel industry in India. A very few studies have been found even at international level. The literature review section has been covering the objectives and findings of relevant studies as follows:

Kim and Gu (2003) studied the risk adjusted performance of economy buffet, fast food and full service restaurants. The performance was measured for the period of 1996 to 2000. The study revealed that fast food restaurants are at top in terms of risk-adjusted performance followed by full service and economy/buffets restaurants. But the performance was lower

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than the return given by market portfolio. They concluded that restaurant firm should continue to consolidate to decrease operating cost and enhance revenues. This will help them to get better market returns without enhancing the systematic risk. **Hsu and Jang (2007)** in their research investigated the financial performance of lodging industry of US between 1985-2000. They examined the impact of M&As through accounting and market measures. The financial performance in terms of ROA and ROE has been found lower after the merger. Similarly, the shareholders of acquirer hotel companies did not get benefitted from these deals. **Kim *et al* (2009)** in their research examined the relationship between long-term market return and method of payment. They took sample of 19 hospitality acquirers from the period of 1996 to 1997. The hospitality acquirers were found successful in receiving positive returns for a period of 12 months. The study also found a negative association between acquirers, excess return and cash payment approach. **Ma *et al* (2011)** in their research analyzed the market return involved in acquisition of listed and unlisted lodging companies of US. The study revealed the positive return generated through these deals by both the categories. The sub-set of unlisted companies has been found to generate significant higher returns at acquisitions by the acquirer companies. **Park and Jang (2011)** in their research work studied the progress of firms that have gone through M&A v/s non-M&A firms during the period of 1980-2007. The study revealed positive sales growth for small as well as large scale acquirers following the year of merger. But the growth has been disappeared after the third year of post-merger. But the growth pattern after this year was same for M&A companies in comparison to non-M&A companies. **Quek (2011)** studied the M&A activity occurred in UK hotel industry over a period of 26 years, that is, 1979-2004. The research is based on a review of a detailed literature in this industry. The study summarizes that value maximizing motives are well met while non-value maximizing motives have not been supported. The study revealed that the brand name is one of the prime objective in M&A deal happened in UK hotel industry. **Gu *et al* (2012)** in this study described the changing structure of Chinese hotel industry during the period 1980-2012. They notified the progress during that period in terms of cross-border M&A by Chinese chains. The study also highlighted the challenge for domestic Chinese industry in the presence of foreign chain operating in China.

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Objectives of the Study

1. To study the financial performance of acquirer companies.
2. To analyze the impact of mergers on the shareholders wealth in short-term period
3. To analyze the impact of mergers on the shareholders wealth in long-term period

Hypotheses of the Study

H_1: Post-merger financial performance of acquirer companies is significantly different from pre-merger financial performance.

$H_{1(a)}$: Post-merger liquidity position of acquirer companies is significantly different from pre-merger liquidity position.

$H_{1(b)}$: Post-merger profitability position of acquirer companies is significantly different from pre-merger profitability position.

$H_{1(c)}$: Post-merger financial solvency position of acquirer companies is significantly different from pre-merger solvency position.

H_2: There is no impact of merger on the wealth of shareholders of acquirer companies in the short-term period.

H_3: There is no impact of merger on the wealth of shareholders of acquirer companies in the long-term period.

Need and Scope of the Study

The present study is examining the impact of mergers on the financial performance and market performance of hotel companies. No such detailed study is conducted in India till date; where as a good numbers of studies are available on US hotel industry. As Indian hotel industry is one of the major contributors in Indian service sector. So, it becomes imperative to have a comprehensive study on that. The study comprises a sample of five acquirer companies, which have undergone through merger during the period 1998-2008. The scope

of the study is confined to acquirer companies of hotel industry in India and covers domestic mergers only.

Research Methodology

Research Design

The present study is an empirical analysis. The study is aiming at assessing the success and failure of mergers by considering accounting as well as market measures.

Sample Designs and Data collection

The present study is based upon a sample of five acquirer companies from Hotel industry in India. The study covers a ten year period of 1998 to 2008. The financial data for the study has been collected from the prominent data base Capitaline and daily stock prices data is collected from the official website of Bombay Stock Exchange (BSE).

Data Analysis

Apart from the traditional approaches of parametric testing, the data has been analyzed with the help of non-parametric test. Financial performance of pre-merger period is compared with post-merger through Wilcoxon Signed Rank Test. Secondly, market performance for both short and long-term period has been examined by non-parametric GRANK test.

Limitations and Scope for Future Research

1. The study is considering only the domestic mergers, it can be further extended to cross border mergers.
2. Acquisitions in that industry can also be added along with merger deals.

Results and Analysis

The financial performance analysis has been conducted for liquidity, profitability and solvency position. The financial ratios have been adjusted with industrial numbers to capture

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Financial Parameters (Industry Adjusted)	Ranks	Mean Rank Value	z-Value	p-Value
Liquidity Position				
Current Ratio	Negative-3 Positive -2	Negative-3.33 Positive -2.50	-0.674	0.500
Inventory Turnover Ratio	Negative-3 Positive -2	Negative-2.30 Positive -4.00	-0.135	0.893
Debtors' Turnover Ratio	Negative-2 Positive -3	Negative-2.00 Positive -3.67	-0.944	0.345

the real impact of mergers on the financial performance of acquirer companies. The three year average of industry adjusted financial parameters of post-merger period is compared with pre-merger industry adjusted financial parameters. The comprehensive analysis is shown in the Table-1. Firstly at the liquidity front the post-merger liquidity position has found as similar as pre-merger liquidity position. Industry adjusted current ratio, inventory turnover ratio and debtors' turnover ratio has not revealed any significant change. Hence, the alternative hypothesis $H_{1(a)}$ is rejected, that is, post-merger liquidity position of acquirer companies is significantly different from pre-merger liquidity position.

Table 1: Result of Wilcoxon Signed Rank Test (Financial Performance)

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Profitability Position				
PBDIT Margin	Negative-2 Positive -3	Negative-4.50 Positive -2.00	-0.405	0.686
Cash Profit	Negative-5 Positive -0	Negative-3.00 Positive -0.00	-2.023	0.043*
ROCE	Negative-2 Positive -3	Negative-4.50 Positive -2.00	-0.405	0.686
Solvency Position				
Debt Equity Ratio	Negative-4 Positive -1	Negative-3.50 Positive -1.00	-1.753	0.080
Long term Debt to Equity Ratio	Negative-4 Positive -1	Negative-3.25 Positive -2.00	-1.483	0.138
Interest Coverage Ratio	Negative-4 Positive -1	Negative-2.50 Positive -5.00	-0.674	0.500

***Source**: Authors' calculations from the data compiled from Capitaline Database.*
**values significant at 5% level.*

Secondly at profitability front, some pressure has been observed upon the profitability parameters, that is, PBIT margins, CPM and ROCE. These all three parameters have registered a decline. But the decline shown by CPM is found significant at 5% level. Above all, the decline is observed as marginal in rest of the profitability parameters. So, the results also rejects the alternative hypothesis $H_{1(b)}$, that is, post-merger profitability position of acquirer companies is significantly different from pre-merger profitability position. Finally at the solvency front, the results are as similar as witnessed above. The solvency parameters have also shown marginal decline. The results lead to the rejection of the hypothesis $H_{1(c)}$, that is, post-merger solvency position of acquirer companies is significantly different from pre-merger solvency position. The above mentioned results rejects all the sub-hypotheses $H_{1(a)}$, $H_{1(b)}$ and $H_{1(c)}$. So, in the light of the results the hypothesis H_1 representing objective no. 1 stands rejected, that is, post-merger financial performance of acquirer companies is significantly different from pre-merger financial performance.

Further, Kolari and Pynnönen (GRANK) test has been applied to gauge the impact of mergers on the wealth of shareholders of acquirer companies in the short-term period. The estimation window has been taken as 249 days along with a estimation window of (-30, 0, +30 days). The expected return during the event window period of 61 days has been calculated as

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$$\mathbf{E}\ (R_t) = \alpha + \beta * R_{mt} + \varepsilon_t$$

Where;

E (R_t) = Expected return for stock *j* at time *t*

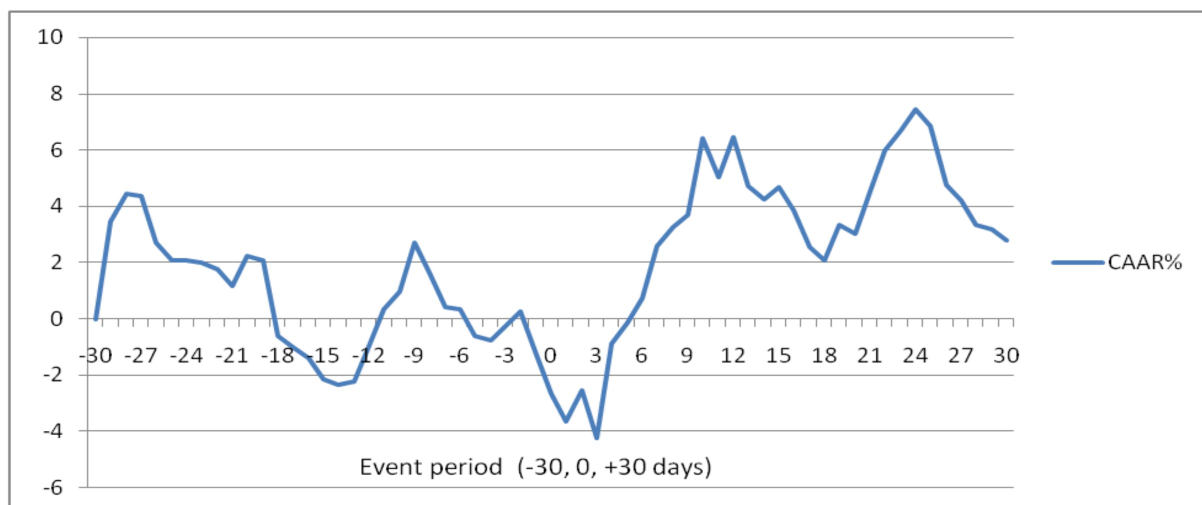
α = Estimate of the intercept of the market model regression.

β = Estimate of the coefficient in the market model regression, measures the sensitivity of the stock *j* to the Sensex.

R_{mt} = Return for Index *j* at time *t*

The abnormal return is calculated by deducting the expected return from the actual return during the event window period of 61 days. The average abnormal return is further cumulated to calculate CAAR (Cumulative Average Abnormal Return) for the 61 days period. The Figure 1 shows a mix response during the event window period. On the 24th day post-merger, it touched the peak level of 7.42% and during next six days, it has lost approximately 5% and closed at 2.76%.

Figure 1: Cumulative Average Abnormal Return during the Event Window of 61 days



***Source**: Based upon the data compiled upon www.bseindia.com*

The GRANK test has been applied to test the abnormality during that period. It is applied upon CAARs captured during the event window period by the following formula:

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$$GRANK = \frac{\sqrt{d}\ X\ (KD - Mean\ Rank)}{\sum_{t=1}^{n}(K_t - Mean\ Rank)^2/n}$$

Where $'KD'$ is the average rank of event window, $'d'$ is the lenght of estimation window, $'n'$ is the lenght of estimation window plus event window.

Here, the d =249 and n=260

Under this method, ranking has been given to abnormal return. The highest positive return got the highest rank and vice-versa. From that data, average rank is claculated and compared with the mean rank of 155.5. The GRANK value is 0.373, which is found insignificant at 5% level. It shows no major change at market front . The GRANK test rejects the alnternative hypothesis H_2, that is, there is no impact of merger on the wealth of shareholders of acquirer companies in the short-term period.

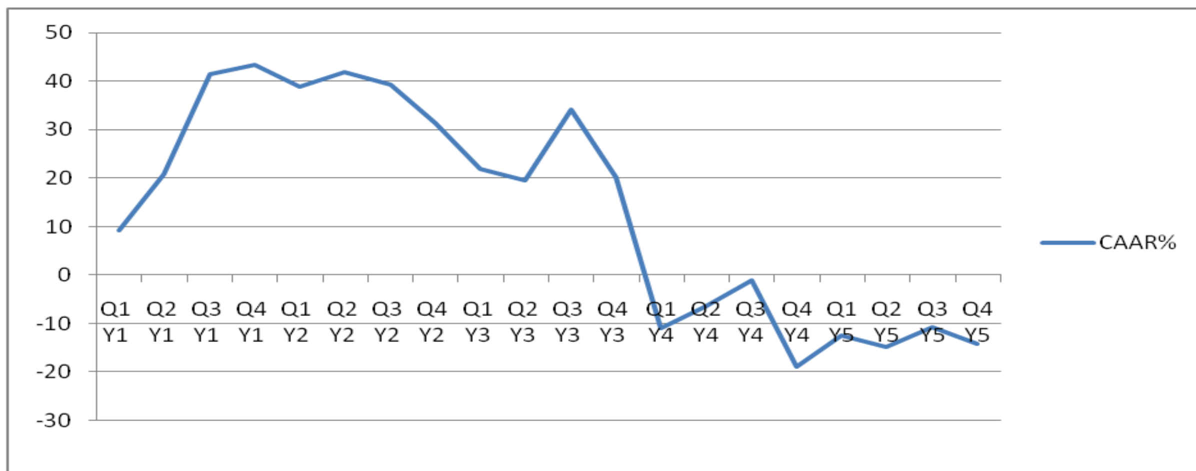
Table-2: GRANK-test Statistics Results for the Event Window of (-30, 0, +30 days)

Estimation Window	Event Window	Average Rank	Mean Rank	GRANK Value	p-Value
249 days	61 days	156.41	155.5	0.373	0.720

Source: *Authors' calculations from the data compiled from www.bseindia.com*
**Values significant at 1% level.*

To satisfy the objective no. 3, the same methodology has been applied as used in objective no. 2. Here, the wealth generation period has been taken as five years divided into twenty financial quarters.

Figure 1: Cumulative Average Abnormal Return during the period of five years



Source:*Based upon the data compiled from www.bseindia.com*

The CAAR is found positive till three years from the effective merger and remained in negative zone afterwards for the next two years. During that period, it has lost all the sheen of positivity. Finally the CAAR closes at the level of -14.28%. By applying the GRANK test, the average rank value for the 20 financial quarters is 138.42, where as mean rank is 135. The p-value of the test is 0.22. The value is found insignificant at 5% level and rejects the alternative hypothesis H_3, that is, there is no impact of merger on the wealth of shareholder of acquirer companies in the long-term period.

Table 3: GRANK-test Results for the Event Window (post-merger 20 financial quarters)

Estimation Window	Event Window	Average Rank	Mean Rank	GRANK Value	p-Value
249 days	20 Financial Quarters	138.43	135	1.421	0.22

Source*: Authors' calculations from the data compiled from www.bseindia.com*
**Values significant at 5% level.*

Conclusion

The findings of the studies have not revealed any major change in financial performance. It shows that mergers in the hotel industry did not lead to the any improvement in the financials of the companies. Similarly, at market front no value creation has been found in the wealth of shareholders in the short as well as long-term period. It shows that at merger announcement, market has perceived the decision of the management in a neutral way. The long-term

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analysis reveals no value creation for the shareholders by this corporate action. In the light of the results, it is being concluded that the hotel companies were not objective towards their decision to take it in a rational manner.

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