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Vacillate the Performance of Textile Sector after the Merger: A Case of Shahzad Textile Mills Limited (STM)

Abstract

Before and after the merger of Shahzad Textile Mills Limited (STM), the financial performance of the company was analyzed. The analysis was carried out using 12 vital ratios and the financial statements for eight years (2008-2016). After getting the results of pre and post-merger (short-run) and post-merger long-run analysis forecasting was done from 2017-2020 which will help management to eliminate uncertainty in future. The analysis was carried out to eliminate the uncertainty in the future. The results of the analysis revealed that the financial performance of the company has been satisfactory after the merger. The long-term results of the analysis revealed that the financial performance of the company was poor before and after the merger. The merger did not provide the company with many benefits over the long run.

Key Words: STM, Merger, Profitability, Financial Performance, Accounting Ratios, Liquidity

Introduction

Energetic changes in the worldwide environment have been converted business surroundings immediately. In current corporations, business transactions have been altered due to the advancement of technology to the global level. It is the dream of every firm to become a greatly regarded organization by maximizing its market share and financial growth. A firm must have to perform efficiently in order to become successful in the market. An organization needs expertise information in order to enter into the new market and meanwhile, they have to implement the best strategies to be stable in the new environment.

In order to deal with the dynamic business environment, organizations go for Mergers and acquisitions (M&A). When two companies merge together to form a joint or single entity for their mutual benefits, it is known as a merger. At the point when an association buys some plant, resources, speciality units, offers or gear of whatever other association or it secures the whole responsibility for associations called acquisition (Sherman 2011). The reason behind any corporate

merger is the interaction effect that two is better than one. The performance of an organization would be better if companies merge or acquires together.

This is qualified by the fact that the value of shareholders would be maximized effectually (Sharma 2009). The M&A has been developed globally but has not full-grown in Pakistan. The actual reason for this incident was nationalization that happened by Pakistan's government in 1970. Due to nationalization the involvement of government was amplified and it disturbed and disheartened the private and commercial industries. Due to the implementation of the World Trade Organization's (WTO) rules, the merger and acquisition activities in Pakistan have become more active. As a result of this, national organizations merge their operations to accomplish effectiveness and keep up their market share in the overall industry within the sight of global contenders due to the intensified competition. Government deregulation and

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relaxation motivate companies, particularly the service sector to merge and gain competitive advantages. Adding more to it, State bank and taxation issues declared minimum capital requirement to merge which forced banks to do so. The merger and acquisition process occurs in non-money related divisions to accomplish the goals. In the textile sector, the merger helped in achieving economies of scale and managing taxation issues. Subsequently, it is imperative to give a little recorded foundation of Pakistan's textile sector. Pakistan's textile industry is the 8th largest industry in Asia. This sector gives work to around 15 million individuals which constitute about 30 % of the work strength whereby the whole work strength constitutes 49 Million. Later 1947 rise in the cotton generation. Merger and acquisition is a process that involves the combination of two or more companies in order to form a joint or single entity. It is referred to as a merger when the two parties agree to share the benefits of the transaction. The main reason why corporate transactions are beneficial is due to the interaction effect. It occurs when two or more companies come together.

The acquisition and merger process has been successfully carried out globally, but it has not been fully developed in Pakistan. This is due to the country's nationalization in 1970. This led to dissension among the commercial and private sectors in the country. Due to the implementation of the rules of the World Trade Organization, more companies in Pakistan are now actively involved in merger and acquisition activities.

The extension of the material industry of Pakistan is great. Upgrade of cotton bundles after 1.1 million clusters in 1947 to ten million posts by 2000. There had been an increase in the plants processing that constitutes from 3 to 600 and axles from around 177,000 to 805 million. Pakistan's textile sector earns 65% foreign exchange of total exports. Experts believe that Pakistan is a heavenly grown industry although 60% to 70% of machines require swap in lieu of

commercial and quality generation of items for a concerned market. There is no central office that can coordinate the various activities related to the modernization and replacement of equipment in material plants. This is especially true for joint activities involving the production of finishing units with other countries.

Problem Statement

In the last few years, many companies have been merged to improve their efficiency and profitability. Before and after the acquisition, various studies have been conducted to analyze the various factors involved in the transaction. A number of these studies revealed that the financial performance of the firms after they were acquired does not improve after the merger. Also, these studies did not find any improvement in the operating activities of the target firms following the acquisition. The objective of this study is to analyze the effects of merger activities on the performance of the textile sector of Pakistan.

Research Questions

- What is the influence of mergers on the Profitability of Shahzad Textile Mills Limited?
- What is the impact of the merger on the Liquidity of Shahzad Textile Mills Limited?
- What is the influence of the merger on the Leverage of Shahzad Textile Mills Limited?

Objectives of the Study

- To find the effects of the merger on Profitability.
- To establish the impact of the merger on the Liquidity.
- To establish the impact of the merger on the Leverage.

Significance of the Study

This study aims to analyze the profitability and the leverage of the textile industry in Pakistan. It also aims to study the motives behind the merger and acquisition. The rapid emergence and evolution of technology have greatly impacted the way business transactions are conducted globally. It is the goal of every organization to become a prominent and profitable business entity.

A successful organization must perform well in order to be successful in the new environment. It needs to have the necessary expertise to be able to implement the right strategies to achieve its goals. Merger and acquisition is a process that involves the combination of two or more companies in order to form a joint or single entity. It is referred to as a merger when the two parties agree to share the benefits of the transaction. The main reason why corporate transactions are beneficial is due to the interaction effect. It occurs when two or more companies come together.

The acquisition and merger process has been successfully carried out globally, but it has not been fully developed in Pakistan. This is due to the country's nationalization in 1970. This led to dissension among the commercial and private sectors in the country. Due to the implementation of the rules of the World Trade Organization, more companies in Pakistan are now actively involved in merger and acquisition activities. Various government regulations and policies have led to the growth of the service sector in Pakistan. This prompted many companies to explore the possibility of merging with others. The merger process helped in achieving various goals such as reducing taxation issues and improving economies of scale. The textile industry in Pakistan is the 8th largest in Asia. The extension of the material industry in Pakistan has been very successful. In 2000, the number of cotton-bundles had increased from 1.1 million to

10 million. The number of plants processing this material has also increased from 3 to 600. According to experts, the material industry in Pakistan is flourishing despite the high number of machines that require swapping.

Literature Review

The question of why companies and individuals merge and acquire businesses has been the subject of numerous studies conducted in the last decade. In this study, the researcher focused on the motives behind the transactions. In 1990, the researcher identified seven theories that explain the various motives behind the various types of transactions. One of these is efficiency, which states that companies do these transactions for the benefit of their shareholders.

Another theory that the researcher presented was the empire-building theory, which states that managers do not care about the maximization of money. The raider theory states that a man who acquires a company can cause riches exchanges among its investors. This occurs when the target firm's management gets proper information about the company's worth. The process theory states that there are various factors that can trigger a merger or acquisition. These include the lack of proper planning, political pressure, and economic crises. M&A transactions are conducted for various reasons such as increasing operational efficiencies, improving corporate governance, and reducing costs. These are also done for the benefit of their shareholders. The researcher also noted that the development status of the target company's country and industry are some of the factors that influence the motives of acquiring firms. In 2014, the researchers conducted a study to analyze the motivations of firms when it comes to cross-border transactions. The study identified five main motives that Indian firms have in mind when it comes to cross-border transactions. These include improving efficiency, marketing and strategic motives, market leadership, and synergistic gain.

The authors of the study conducted in 2003 analyzed the financial performance of a textile firm. They found that the company's financial indicators did not indicate its strong financial position. They also suggested that the management should improve the affectivity of its workforce. The authors of the study also looked into the profitability of organizations following an acquisition. They found that it decreased after the deal was carried out. They also noted that the acquired company's worth was formed through various factors. In 2015, the authors of another study analyzed the factors that influence the choice of Indian firms when it comes to acquiring and merging. They found that controlling and accessing innovation resources are vital factors that can help in securing the best possible choice for a company.

A study conducted on the gainfulness of firms after their merger or acquisition was carried out in Ghana's stock market. It found that the acquired company's gainfulness differed from that of the prior firm. The study also noted that the acquired firm's unfavorable association with the gainfulness of the prior firm was also observed. A 2012 study conducted on the profitability of Indian airlines revealed that there was no significant improvement in the areas of profitability following the merger. The banks also noted that there was no significant impact on their operations following the transaction.

The effects of cross-border transactions on the profitability of various Tata group companies were studied. For instance, the specialist translated that the merger and securing significantly affected the statuses of Tata Power and Tata Correspondence. The researchers also used a stock price evaluation method to determine the market value of the firms. They also looked into the effects of mergers and acquisitions on the stocks costs of ethanol-based firms in the US. The results of the study indicated that the market reacted favourably to the

acquisition and merger of firms. Stunda also looked into the effects of acquiring firms that were not included in the deal. He found that the firms that were not involved in the merger or acquisition process were able to benefit greatly from the lower stock cost. However, the acquired firms experienced a negative effect on their stock cost. The study was focused on the returns of investors through the transactions of UK-based firms from 1996 to 2007. It revealed that the number of firms that attracted buyers decreased during the study period.

Despite the expected returns, the long-term significance of the acquisition and the holding anomalous returns was also acknowledged. Using a cross-sectional regression, the researchers discovered that enhancing an acquisition leads to higher anomalous returns. In 2012, a group of researchers conducted an examination in Pakistan to study the effects of the merger and acquisition on an organization's operations. The researchers also looked into the effects of the merger and acquisition on the share cost of various organizations. Through an event study, they were able to identify the factors that affected the share cost of these firms.

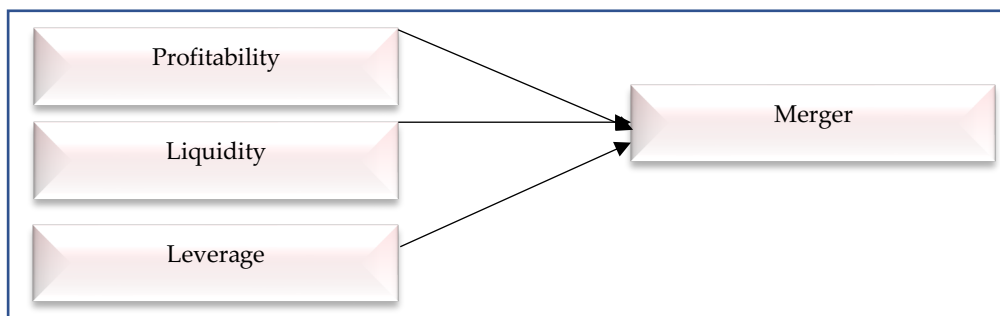
The results of the study revealed that the positive changes brought about by the merger significantly affected the offer costs of five firms. However, the negative effects of the acquisition were discovered in two companies a month following the deal. The study also looked into the effects of the merger and acquisition on the profitability of banks. Through statistical analysis, the researcher identified the factors that affected the profitability of the firms following the transaction.

Theoretical Framework

The objective of this study is to find out if the merger of two or more textile companies can improve the profitability of the industry. The profitability of a corporation is mainly

determined by the various financial ratios such as the liquidity ratio and the solvency ratio. These ratios help in estimating the worth of the company. The researchers also looked into the effects of the merger and acquisition on the share cost of various organizations. Through an event study, they were able to identify the factors that affected the share cost of these firms.

The researcher has used the profitability, liquidity, and leverage of a company as the dependent variables for the study. He or she then takes the merger as an independent variable and analyses its effects on these key factors.



Methodolog

Sample

The study focuses on the annual reports of Shahzad textile mills Limited, which was merged with Shaheen cotton mills Limited in 2010.

Table 1. Shahzad Textile Mills Limited Taken as Sample which is an Acquirer Company

Serial no	Type of pact	Date of pact	Acquirer	Target industry
1	Merger	2/8/2010	Shahzad textile mills Limited	Shaheen cotton mills Limited

Data Collection

The data collected in this study is mainly derived from secondary data sources such as the website of the Pakistan stock exchange and the internet.

Instruments and Measures

The financial performance of a selected textile mill is analyzed from 2008 to 2016. The profitability, liquidity, and solvency ratios of the selected mill are calculated for the period 2008 to 2016. Two years before and two years after the

financial data is analyzed to ensure that the results are as accurate as possible. Short-run financial performance does not tell the real financial position of a company. The long-run financial performance is also calculated and forecasted from 2017 to 2020 to help management make informed decisions.

Procedure

Performance indicators are also calculated and presented in excel to help in forecasting the financial performance of a company.

Table 2. Proxies to Measure the Financial Performance

Variables	Ratios/Indicators	Formulas
Profitability	Gross Profit Margin	$\text{Gross Profit} / \text{Sales} \times 100$
	Net Profit Margin	$\text{Net Profit} / \text{Sales} \times 100$
	Operating Profit Margin	$\text{Operating Profit} / \text{Sales} \times 100$
	Return On Asset (ROA)	$\text{Net Profit} / \text{Total Assets} \times 100$
Liquidity	Return On Equity (ROE)	$\text{Net Profit} / \text{Equity} \times 100$
	Current Ratio	$\text{Current Assets} / \text{Current Liabilities}$
	Quick Ratio	$(\text{Current Assets} - \text{Inventory}) / \text{CL}$
	Cash Ratio	$\text{Cash} + \text{Marketable Securities} / \text{CL}$
Leverage	Investment to Total Assets	$\text{Investment} / \text{Total Assets}$
	Debt to Equity	$\text{Total Liabilities} / \text{Equity}$
	Capital Ratio	$\text{Total Equity} / \text{Total Assets}$
	Debt Ratio	$\text{Long Term Debts} / \text{Total Assets}$

Results

Profitability

It would appear that when buying highly profitable firms, the acquiring companies carried out a zero-sum acquisition price game in which they maximized the profitability of the deal. This strategy led to a decline in the average post-merger return.

Liquidity

The question of how banks create liquidity is the subject of this paper. It uses two measures, namely, cat fat and nonfat, to analyze the changes in liquidity creation following bank mergers. The results support the deposit insurance hypothesis, which states that higher deposit insurance levels are expected to improve a bank's liquidity. The increase in liquidity created by a merger is usually associated with the large acquirers' equity capital, which explains the change in the size of the merger's effect on the market.

Leverage

Despite the current economic slowdown, the industry's ability to create liquidity is still constrained by the lack of assets and equity. This study focuses on the impact of bank mergers on bank liquidity. The results of our study show that when firms are highly levered, acquiring them can have a negative impact on their post-merger performance.

Unfortunately, increasing the timeframe for analyzing a study would reduce the sample size and quality of our analysis. This would enable us to collect more data on all the companies involved in the M&A transaction. The importance of our study is also linked to the financing scheme used by private firms for acquiring public companies. This could be an area where our model could be applied.

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