Corporate Restructuring & Acquiring Firms' Performance : An Empirical study of few Selected Firms of Oil & Gas Sector in India

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Abstract

The corporate sector in India is undergoing structural changes as a result of liberalization, privatization and openness policies of the Government since early 1990s. Competitive pressures are high not only due to deregulation but also due to globalization. Restructuring in the context of corporate management could be seen as the act of reorganizing the legal, ownership, operational or other structures of a company. It is usually done for the purpose of making such companies more profitable or better organized to meet their present realities and challenges. Restructuring may include a change of ownership or ownership structure, demerger or a response to a crisis or major change in the business such as bankruptcy, repositioning or buyout. Along with the rise in the number of Merger and Acquisition (M&A) deals, the amount involved in such deals has risen over time. There is also an increase in the number of open offers, albeit at a slower pace. With rising global energy demand, the oil and gas industry has a wide range of challenges and opportunities across the upstream, midstream, downstream and oilfield services sectors. This paper discusses the corporate restructuring strategy and financial performance of the four selected firms in the oil and gas industry. The study has been based on secondary data collected about acquiring firms five years during pre merger and five years during post merger period excluding the year of merger/acquisition.

Keywords: Corporate Restructuring, Mergers and Acquisitions

1. Introduction :

Corporate restructuring generally refers to the process of redesigning one or more aspects of a company. It entails any fundamental change in a company's business or financial structure. It is designed to increase the company's value to shareholders or creditors. Norley et al. (2001) define restructuring as the act of reorganizing the legal, ownership, operational or other structures of a company for the purpose of making it more profitable and better organized for its present needs. Alternate reasons for restructuring include a change of ownership or ownership structure, demerger, a response to a crisis or major change in the business such as bankruptcy, repositioning or buyout.

2. Review of Literature :

Bowman & Singh (1999) state that organizational restructuring strategies consist of three modes; portfolio, financial and organizational restructuring. There are symptoms that may indicate the need for organizational restructuring (Hane, 2000). Such symptoms include: parts of the organization are significantly over or under staffed; organizational communications are inconsistent, fragmented, and inefficient; technology and/or innovation are creating changes in workflow and production processes; significant staffing increases or decreases are contemplated; new skills and capabilities are needed to meet current or expected operational requirements; accountability for results are not clearly communicated and measurable resulting in subjective and biased performance appraisals; personnel retention and turnover becomes a significant problem; stagnant workforce productivity or deteriorating morale.

Drogalas (2006) stated that one of the main elements of contemporary corporate restructuring is the boom in mergers and acquisitions. Mergers and Acquisitions are used for improving competitiveness of companies and gaining competitive advantage over other firms through gaining greater market share, broadening the portfolio to reduce business risk, entering new markets and geographies, and capitalizing on economies of scale etc (Saboo and Gopi, 2009). Merger and Acquisition (M & A) agreement is taken not necessarily because of lack of corporate strength but an avenue to create synergy. Many corporations find that the best way to get ahead is to expand ownership boundaries through mergers and acquisitions (Ismail, Abdou and Annis, 2011).

According to Cascio (2002), debt restructuring also qualifies as financial restructuring. This process allows a private or public company facing cash flow problems and financial distress to reduce and renegotiate its delinquent debts in order to improve or restore liquidity and rehabilitate so that it can continue its operations. Cascio (2002) contends that the investment pattern of a company which relates to ability of corporations to identify the various investments opportunities that would lead to higher returns is part of the restructuring procedure. Financial restructuring may be accomplished with the motive to enhance liquidity, lower the cost of capital, reduce risk, avoid loss of control, and improve shareholder value, among many other reasons (Cascio, 2002).

The oil and gas sector is among the six core industries in India and plays a major role in influencing decision making for all the other important sections of the economy. In 1997–98, the New Exploration Licensing Policy (NELP) was envisaged to fill the ever-increasing gap between India's gas demand and supply. A recent report points out that the Indian oil and gas industry is anticipated to be worth US$ 139.8 billion by 2015. India's economic growth is closely related to energy demand; therefore the need for oil and gas is projected to grow more, thereby making the sector quite conducive for investment. The Government of India has adopted several policies to fulfil the increasing demand. The government has allowed 100 per cent foreign direct investment (FDI) in many segments of the sector, including natural gas, petroleum products, and refineries, among others. Today, it attracts both domestic and foreign investment, as attested by the presence of Reliance Industries Ltd (RIL) and Cairn India.

3. Market Size :

Backed by new oil fields, domestic oil output is anticipated to grow to 1 MBPD by FY16. With India developing gas-fired power stations, consumption is up more than 160 per cent since 1995. Gas consumption is likely to expand at a CAGR of 21 per cent during FY08–17. Presently, domestic production accounts for more than three-quarters of the country's total gas consumption.

India increasingly relies on imported LNG; the country was the fifth-largest LNG importer in 2013, accounting for 5.5 per cent of global imports. India's LNG imports are forecasted to increase at a CAGR of 33 per cent during 2012–17. However, net imports of Natural Gas fell from 13.14 BCM in 2012-13 to 13.03 BCM in 2013-14.

State-owned Oil and Natural Gas Corporation (ONGC) dominates the upstream segment (exploration and production), accounting for approximately 68 per cent of the country's total oil output (FY14). Indian Oil Corporation Limited (IOCL) operates 11,214 km network of crude, gas and product pipelines, with a capacity of 1.6 MBPD of oil and 10 million metric standard cubic metre per day (MMSCMD) of gas. This is around 30 per cent of the nation's total pipeline network. IOCL is the largest company, operating 10 out of 22 Indian refineries, with a combined capacity of 1.3 MBPD

4. Objectives :

The broad objective of this study is to measure the impact of mergers and acquisitions on financial growth indicators in Indian Oil and Gas Sector. Other objectives of the study are :

a) To examine and evaluate the impact of mergers and acquisitions on the sufficiency and efficiency position;

b) To examine and evaluate the impact of mergers and acquisitions on the liquidity and leverage position;

c) To examine and evaluate the impact of mergers and acquisitions on the profitability position.

These objectives have been resolved through various methodological aspects, including quantitative methods of analysis.

5. Hypotheses :

Based on the above objectives, the following hypotheses have been identified for the study:

a) H_1: There is significant differences in sufficiency (adequacy of cash flow for meeting the firm's needs) of firms, before and after merger and acquisition.

b) H2: There is significant differences in efficiency (internal uses of assets and liabilities) of firms, before and after merger and acquisition.

c) H3: There is significant differences in liquidity position of firms, before and after merger and acquisition.

d) H_4: There issignificant difference in leverage of firms, before and after merger and acquisition.

e) H_5: There is significant difference in overall profitability of firms, before and after merger and acquisition.

6. Methodology :

This study is based on secondary data. The oil and gas sector in India has been instrumental in fuelling the growth of the Indian economy, hence presenting a significant opportunity for investors in the years to come. The government have also been doing its bit in recent times to deregulate the industry and encourage greater foreign participation. India is the world's fifth biggest energy consumer and continues to grow rapidly. The oil and gas sector is dominated by state consumer and continues to grow rapidly. It controlled enterprises with ONGC the third-biggest global coal producer, but largest upstream-oriented oil company has limited its supplies of oil.

Four firms have been selected which have acquired other units. This selection of firms is based on availability of information and importance of the firm. The company's website and annual reports have been referred to. The data source "**ISI Emerging Markets**" is the main source from which relevant information have been collected. The profiles of both acquiring and acquired firms at the time of merger/acquisition have been collected from annual reports, newspaper clippings, websites, etc.

Data have been collected about the acquiring firms five years during pre-merger period and five years during post-merger period excluding the year of merger/acquisition. Therefore, a total of ten years of data have been collected.

The ratio analysis method has been used. Ratio analysis is a process of identifying the financial strengths and weaknesses of the firms. Therefore, data relating to financial performance for five years during pre-merger period and five years during pos-merger have been analyzed. The variables (ratios) that have been selected to measure the financial performance of the acquiring firms are Sufficiency, Efficiency, Liquidity, Leverage, Activity and Profitability ratios. The test of significance ('t') has also been applied to infer the differences between pre and post-merger period.

7. Brief Profile of the firms taken for study :

The list of acquiring and acquired firms has been mentioned below :

Table-1 : List of Acquiring and Acquired firms

Sl. No.	Acquiring Firm	Acquired Firm	Country of Operation	Month/ Year of Acquisition
1.	ONGC	Imperial Energy	Russia	March, 2009
2.	IOCL	BRPL	India	March, 2009
3.	Essar Oil	Kenya Petroleum Refineries Ltd.	Kenya	July, 2009
4.	GAIL	NATGAS	Egypt	August,2004

7.1 ONGC acquiring Imperial Energy

The Imperial Group was acquired by ONGC Videsh Limited (OVL), the overseas arm of Oil and Natural Gas Corporation (ONGC), the flagship national oil company of India on January 13, 2009 Imperial was delisted from LSE.

Imperial Energy Group had started its operations in the territory of the Russian Federation since October 18, 2004. The Group was founded by Russian and foreign investors as an independent middle-size oil producer. Imperial Energy was a company of international level. In 2004, Imperial Energy listed its shares on London's AIM exchange, then moved to the main LSE market in May 2007 and became a constituent of the FTSE 250 Index.

In 2004-07, Imperial Energy purchased the licenses for the underdeveloped and poorly developed blocks in Tomsk region and Qostanay (Kazakhstan) and conducted to vast program of exploration works on them, which led to new fields discoveries in Tomsk region. In 2006, Imperial Energy established its own drilling company, RUS-IMPERIAL Group (RIG) which operated three heavy duty drilling rigs, three work over rigs and a coiled tubing unit.

ONGC is one of the largest oil and gas companies not only in India, but in the world. As per Platt 250 Global Energy company List for 2013, ONGC ranked 3rd E&P company in the world and 22nd among leading global energy majors. As per Forbes Global 2002 list ONGC occupied 155th rank among the leading world companies. The company operates in the foreign market through its subsidiary ONGC Videsh Ltd. (OVL).

7.2 IOCL acquiring BRPL

Indian Oil Corporation Ltd. (IOCL) acquired 74.46 per cent stake in Bongaigaon Refinery & Petrochemicals Ltd. (BRPL) on March 26, 2009. The Ministry of Corporate Affairs, Govt. of India approved the merger of govt. companies and sanctioned the scheme of amalgamation for merger of Bongaigaon Refinery & Petrochemicals Ltd. (subsidiary of Indian Oil) with Indian Oil Corporation Ltd. under section 391(2) read with section 394 of the Companies Art, 1956. The scheme of amalgamation periods for a swap ratio of 4:37, i.e. 4 equity shares of Rs. 10/- each of Indian Oil (the transferee company) as finally paid for every 37 equity shares of Rs. 10/- each of Bongaigaon Refinery & Petrochemicals Ltd. (the transferred company). BRPL owned 2.35 million tonnes per annum refinery in Assam and petrochemical units.

7.3 Essar Oil Ltd. acquiring Kenya Petroleum Refineries Ltd. (KPRL)

Essar Energy Overseas Ltd. acquired 50 per cent stake from Shell and Chevron in Kenya Petroleum Refineries Ltd. on July 31, 2009. The Kenya Petroleum Refineries Ltd. serves the East Africa region in the supply of a range of oil products including liquified petroleum gas, unleaded premium gasoline, regular petrol, automotive gas oil, industrial diesel, fuel oil, and special products like bitumen and grease. KPRL had two refinery complexes with distillation, hydro treating, catalytic reforming, and bitumen production units. Crude oil from the middle east is transported by sea to Kipevu Oil Jetty in Kilindini Harbour and then carried by pipeline to the refinery. The finished products are also transferred to customers by pipeline.

Essar Energy is a fully integrated oil and gas company of international scale with strong presence across the hydrocarbon value chain from exploration and production to oil retail. It has a portfolio of onshore and offshore oil and gas blocks worldwide.

With this acquisition, Essar was expected to play a major and vital role in the African oil and gas markets. KPRL's products are sold in the Kenyan market and are exported to neighbouring countries including Tanzania, Uganda, Burundi and Rwanda. "The entry of Essar is a major milestone that will allow KPRL, with the support of the two shareholders (Gox and Essar) to embark on the path of modernization and growth as it seeks to meet the national and regional demand for petroleum products," said the then General Manager, KPRL.

7.4 GAIL acquiring NATGAS

Gas Authority of India Ltd. (India) Limited signed an agreement on 17 August, 2004 with Egypt Kuwait Holding, Egypt to acquire a participating interest in National Gas Company (NATGAS) of Egypt. The agreement was signed by the Director, GAIL (India), and the Managing Director, Egypt Kuwait Holding Company, in New Delhi in the presence of Egyptian embassy officials. Under this agreement, "GAIL will acquire a 15 per cent participating interest in NATGAS at a price of US $19 million". NATGAS was the largest private local distribution company (LDC) for natural gas in Egypt with participating interests by Egypt Kuwait Holding, Shell Gas B.V., Petrogas, Jaicorp, and GAIL (India) Limited. Commenting on the agreement, Mr Proshanto Banerjee, the then Chairman and Managing Director, GAIL said, "GAIL made an investment of US $22 million in Egypt, which is the largest investment made by GAIL in any country till date. Egypt is a focus country for GAIL and we hope that this partnership shall also help grow other business areas in Egypt and its neighboring countries". Speaking at the signing, Mr. Moataz Al Alfi, the then Managing Director, Egypt Kuwait Holding Company said, "Egypt and India have had strong historic ties. The teams from GAIL and Egypt Kuwait Holding deserve to be complimented for inking this agreement. We look forward to a lasting partnership with GAIL". As part of its globalization plans, GAIL is also looking at other African and West Asian countries and is keen to associate with Egypt Kuwait Holding and other players in cross-country gas pipeline projects in countries like Jordan and Lebanon. GAIL is currently pursuing globalization opportunities in Iran, Myanmar, Bangladesh, Turkey and the Philippines.

8. Data Analysis :

The tables below show the financial performance of the four firms taken for study in the pre and post merger period. The 't' test has been used to test the significance of the ratios:

Table- 2 : Financial Performance of Oil &Natural Gas Corporation

Leverage Ratios				
Total Debt Ratio	0.06	0.07	-0.324	0.762
Debt-Equity Ratio	33.67	10.18	1.397	0.235
Capital Equity Ratio	1.06	0.87	0.913	0.413
Interest Coverage	107.52	91.44	0.112	0.916
Activity Ratios				
Inventory Turnover	13.50	9.99	1.397	0.235
No.of days Inventory	26.74	23.18	0.590	0.587
Debtors Turnover	14.87	9.88	2.045	0.110
Collection period	24.48	23.59	0.133	0.901
Assets Turnover	1.14	0.76	1.681	0.168
Working Capital Turnover	3.83	9.29	-1.449	0.221
Profitability Ratios				
Net Margin	0.22	0.15	0.082	0.082
PAT to EBIT	0.64	0.52	0.905	0.417
Return on Investments (ROI) before tax	0.39	0.21	2.877	0.045
Return on Investments (ROI) after tax	0.25	0.14	2.771	0.050*
Return on Equity	0.27	0.15	2.947	0.042
EPS	82.17	27.54	6.360	0.008*
DPS	344.00	222.50	2.316	0.082
Payout	4.26	6.77	1.647	0.198

* Significant at 95% confidence interval

Table 2 shows a comparison of pre and post-merger averages. As per the table, the sufficiency ratios have decreased in the post-merger period. The cash flow adequacy (t=2.082), dividend payout and depreciation-amortization ratios have decreased in the post-merger period, but the change is not significant. Dividend payout decreased to 0.17 in the post-merger period. As far as efficiency ratios are concerned, the average of post merger efficiency ratios has also decreased, but it is statistically insignificant.

The liquidity ratios (t = 5.516 and 5.679) have decreased post merger and is statistically significant. A low liquidity ratio means the firm has inadequacy of working capital to fund short term financial requirement. The debt equity and interest coverage ratio has decreased post merger to 10.18 and 91.44 however, it is statistically insignificant at 95 per cent significance level. ONGC's activity ratios have decreased in the post merger period.

There is no significant change in the activity ratios though the averages of the ratios have decreased marginally. Profitability ratios have decreased post merger. There has been a sharp decrease in the average DPS (t = 2.316) post merger and it is marginally significant. There has been a significant change in return on investment (t=2.877), return on equity(t=2.947) and EPS (t=6.360) 95% level of significance due to the decrease in the averages.

Table-3 : Financial Performance of Indian Oil Corporation Ltd.

Variables	Pre Merger Average	Post Merger Average	't' Value	Sig Value (2 tailed)
Sufficiency Ratios				
Cash Flow Adequacy	0.53	0.20	0.476	0.659
Long Term Debt Payment	-1.85	-5.03	0.687	0.530
Dividend Payout	-0.55	-0.72	0.212	0.843
Reinvestment	-0.28	-0.88	0.635	0.560
Debt Coverage	-10.68	-21.49	0.577	0.595
Depreciation Amortization Impact	-0.86	-1.52	0.483	0.654

* Significant at 95% confidence interval

From the above table, it is found that there is no significant change in the sufficiency ratios. It is evident that the cash flow adequacy (t=0.476), dividend payout and reinvestment ratios have decreased post merger but do not shows any significant changes post merger. Cash flow adequacy declined to 0.20, dividend payout declined to -0.72 and reinvestment ratios declined to -0.88 during the post merger period. As far as efficiency ratios are concerned, the average of post merger efficiency ratios has also decreased, but it is statistically insignificant.

The current ratio (t=5.947) has decreased post merger and is statistically significant. A low liquidity ratio means the firm has inadequacy of working capital to fund short term financial requirements. The interest coverage (t=5.911) ratio has decreased post merger and is statistically significant.

There is no significant change in the company's activity ratios. Statistically, there seems to be no change in the ratios post mergeraverage due to the marginal increase/ decrease of Inventory and Debtor's Turnover. Inventory and Debtor's turnover increased to 6.43 and 39.72 respectively. Overall, for Indian Oil Corporation, the profitability ratios have decreased post acquisition of Bongalgaon Refinery and Petrochemicals Ltd (BRPL). The net margin (t=4.472), return on investment (t=3.294 and 3.086), return on equity(t= 5.129), DPS (t=2.326) and payout (t=2.944) have decreased and there is a significant change for the same.

Table-4 : Financial Performance of Essar Oil Ltd.

Variables	Pre Merger Average	Post Merger Average	't' Value	Sig Value (2 tailed)
Profitability Ratios				
Net Margin	0.05	0.30	-1.052	0.352
PAT to EBIT	0.69	-2.57	1.197	0.297
Return on Investments (ROI) before tax	0.00	0.03	-1.502	0.208
Return on Investments (ROI) after tax	0.00	-0.03	-0.875	0.431
Return on Equity	-1.04	-0.31	1.352	0.248
EPS	-0.26	-5.24	-0.972	0.403
DPS	0.07	0.14	-0.138	0.897
Payout	0.00	0.00	0.000	0.000*
Sufficiency Ratios				
Cash Flow Adequacy	0.00	0.06	-2.860	0.046*
Long Term Debt Payment	10.60	4.64	0.729	0.506
Dividend Payout	0.00	0.00	1.000	0.374
Reinvestment	11.02	1.37	0.342	0.749
Debt Coverage	-0.22	6.14	-0.139	0.896
Depreciation-Amortization Impact	0.00	0.00	0.000	0.000*
Efficiency Ratios				
Cash flow to Sales	-0.03	0.01	-0.427	0.691
Operations Index	2.35	5.65	-0.685	0.531
Cash flow return on assets	0.00	0.02	-1.986	0.118
Liquidity Ratios				
Current Ratio	0.87	0.68	0.771	0.484
Quick Ratio	0.55	0.35	1.587	0.188
Leverage Ratios				
Total Debt Ratio	0.74	0.65	0.537	0.620
Debt-Equity Ratio	0.36	0.21	1.765	0.152
Capital Equity Ratio	3.88	7.27	-0.917	0.411
Interest Coverage	-0.50	1.30	-0.798	0.470
Activity Ratios				

*Significant at 95% confidence interval

Table 4 shows pre and post merger average ratios post the company's acquisition of Kenya Petroleum Refinery Ltd. From the table, it is known that the cash flow adequacy and long term debt payment ratios have increased in the post merger period, but it is statistically insignificant. Cash flow adequacy has increased from 0.00 to 0.03, whereas long term debt payment increased from -10.60 to 4.64 in the post merger period. The average of post merger efficiency ratios has increased, but it is statistically insignificant.

The liquidity ratios have decreased post merger and is statistically insignificant. Leverage ratios of Essar Oil do not show any significant changes post merger. The marginal increase/decrease doesn't have any significant impact on the post merger leverage ratios. There are significant changes in the Debtor's (t=-2.923) and Assets turnover (t=-3.545) for the company.

Activity ratios are used to evaluate the efficiency with which the firm manages and utilises its assets. There is marginal increase in the ratios. Return on Investment before tax (t=-2.860) shows a significant change because of the increase in its average post merger. It increased from 0.00 to 0.06 over the ten year time period. Return on Equity and EPS have decreased but they aren't statistically significant. Return on Equity and EPS declined to -0.31 to -3.24 respectively.

Table-5 :Financial Performance of Gas Authority of India Ltd.

Profitability Ratios				
Net Margin	0.21	0.21	0.000	1.000
PAT to EBIT	0.81	0.91	-2.059	0.109
Return on Investments (ROI) before tax	0.33	0.25	4.536	0.010*
Return on Investments (ROI) after tax	0.28	0.23	2.654	0.057
Return on Equity	0.38	0.29	4.890	0.008*
EPS	19.15	28.97	-3.918	0.017*
DPS	4.36	8.50	-3.658	0.022*
Payout	0.22	0.30	-2.457	0.070

* Significant at 95% confidence interval

Table 5 shows the pre and post merger average ratios of GAIL. From the table, it is clear that the cash flow adequacy ratio (t =0.735) has decreased in the post merger period. There is an increase in the long term debt payment, reinvestment and debt payment ratio, but it is not statistically significant. The cash flow to sales (t=2.408) and operations index (t=2.492) ratio have decreased post merger and it is marginally significant. There is an increase in the cash flow return on assets (t=2.492) in the post merger period. Statistically, the increase is said to be significant at 95% level of significance.

The liquidity ratios have increased post merger, but it is statistically insignificant. Current and quick ratio increased from 1.56 and 1.42 to 1.62 and 1.52 respectively. A firm should ensure that it does not suffer from lack of liquidity, nor does it have excess liquidity. The average ratios of the company do not have any significant change statistically.

The interest coverage ratio has increased post merger but it is statistically insignificant. There is significant change in the inventory turnover (t=-2.978) post merger as the average has increased. Due to the decrease in assets turnover (t=3.210) and working capital turnover (2.491) in the post merger period, there is significant change of the same. There is a decline in the average of return on investment (t=2.654) and return on equity (t=4.890) and the change is statistically significant. There has been a significant change in Earning per share (t=-3.918) and Dividend per share (t=-3.658) as the post merger average has increased. Payout (t=-2.457) is marginally significant due to the post-merger increase.

9. Conclusion :

The present study is analytical in nature. It focuses on the trends in pre and post merger financial performance. The firms under oil & gas industry did not exhibit encouraging performance after acquisition. All four firms registered negative growth in cash flow adequacy and cash flow to sales. Essar Oil's performance was not impressive in cash flow adequacy and cash flow to sales, but it was highly satisfactory in case of ROI after tax (472%), return on equity (2639.5%) and EPS (1519%).ONGC's performance declined on all fronts after merger, whereas GAIL registered an increase in case of current ratio (4.4%), profitability (net margin 0.34%), EPS (46.6%) and DPS (95%). In case of other variables, the performance declined.

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