Business Financial Markets

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Executive Summary:

Merger is one of the crucial elements of strategic management that is used for business expansion. However, there exist debates over the benefits derived through merger in reality. Companies are often unable to identify the benefits derived from merger. The current study conducts a critical review of existing literatures related to merger and acquisition along with a financial analysis of both Singapore airlines and Virgin atlantica. The study is mainly based on secondary data analysis. The study reveals that the merger between the two companies mentioned above did not bring any significant benefit to the financial performance and financial position of the two companies. There has been marginal improvement in profitability and revenues however fall in liqudity position of the company remains a concern. The study suggests that both Singapore airlines and Virgin atlantica needs to focus on cost reduction, business expansion in unexplored markets and implement BSC approach in the organisation.

1.1 Introduction:

Merger and acquisition has long been two of the most popular strategies for business expansion. Companies indulge in merger or acquisition to expand business as a part of the corporate strategy. Several studies have also been conducted in this area. Merger refers to a business partnership through which two or more companies share individual resources and work together for common interests. On the other hand, an acquisition refers to the purchase of a business by another firm. However, a majority of the modern scholars are of the view that merger and acquisition do not bring any real benefit to the concerned companies. There have been several cases of failure of merger and acquisition across the globe. The current study is concerned with the critical evaluation of merger and acquisition in context to the case of atlantic airlines and virgin in Singapore. The study seeks to find out if the concerned merger had been able to improve the financial performance of the companies or not.

1.2 Importance of the study:

Companies often resort to merger or acquisition to expand business operations but often fail to understand if the said merger or acquisition has fetched any significant financial benefit in reality or not. Inability to properly recognise the benefit of merger can be critical as entering into a merger involves huge financial costs and other strategic implications. The issue is more critical at modern times because of intense market competition and rapid changing business environment. The current study is pivotal to the corporate world and the scholars as well as it conducts critical review of existing literatures along with financial analysis to understand the impact of merger between Atlantic airlines and virgin in reality. The study further helps in understanding the benefits and weaknesses of the concerned merger.

1.3 Context of the companies:

Singapore Airlines:

Singapore airlines is one of the largest airlinesin Asia that operates in multiple countries. The company was established in 1947 with the incorporation of Malayan Airways Limited. The company has acquired Virgin Atlantica in the last decade and has also evidenced sharp growth since its inception.

Virgin Atlantica:

Virgin Atlantic was formed in 1984 as British atlantic airways. Currently, only 51% of the stake is owned by the company. In 2012, the company took the seventh place in the Uk airline in terms of passengers' travelled for the year.

Literature review:

2.1 Merger & Acquistion:

Merger is the legal process through which two or more firms enter into a business partnership to share individual resources and strengths to meet some common goals. On the other hand, acquisition is the process through a firm purchases another one to become the owner of the firm. The key difference between merger and acquistion is that the former leads to the creation of a new business entity whereas the later does not result in the formation of a new business entity. In addition to this, firms merging together have equal ownership and managerial rights over the business affairs whereas in case of acquisition the buying firm has the main ownership and manegarial rights.

2.2 Causes for firms to enter into merger:

The factors contributing to the merger between two or more companies can differ from one firm to the another. In other words, the reasons for which firms enter into merger with anotehr one can vary from one firm to the another. In this context, Das et al. (2009) stated that firms often enter into mergers to increase capacity to meet increased demand of customers in the market. Two companies might not be capable to meet rising cusstomer demands individually however the same can be done through sharing of individual resources, intellectual properties and strengths and this motivates the firms to enter into a business merger. On ther other hand, merger is also viewed as an effective tool to cut down competition as the firms involved in a merger would not compete with each other (Boschma and Hartog, 2014). In addition to this, merger helps firms to increase individual competitive edge over the other rivals in the market.

2.3 Evaluation of the advantages and disadvantages of merger:

Traditionally, it is believed that mergers fetch certain strategic and financial benefits to the concerned firms. However, modern scholars have raised certain questions on the real life benefit of merger which furthr raises doubt on the actual or material benefits that companies receive from merger. According to Gleich et al. (2010), merger enables firms to make optimum utilisation of organisational resources and reduce operational costs through large scale production. This further results into higher revenues and profitability of the firms. Higher utilisation of organisational resources allows firms to increase competitive edge over the rivals. Business performance of the firms increase as a result of merger. In addition to this, the share prices of the firms involved in a merger are also expected to rise as shareholders expect greater profitability and earnings per share because joint business operations. On the contrary, Pasco and Le Ster-Beaumevieille (2007) argued that merger leads to dilution of control and organisational conflicts. The ownership structure gets completely changed rather diluted when two firms merge with each other. The leadership style followed by the two firms also might not be the same resulting in organisational conflicts and managerial disputes. These factors can reduce the effectiveness and benefits from merger. Difference in organisational culture can also be yet another reason for the disputes between the employees of the two firms (Marks and Mirvis, 2012). There are different models and tools for valuation of business in case of merger but there seems to be a lack of adequate tools to evaluate the qualitative aspects of merger. On ther other hand, firms take decisions relaated to merger mainly based on historic trends and figures. However, historic figures and trends might not follow in future. However, Tong (2004) expressed that merger improves the research and development activties of an organisation resulting in better innovations. On the other hand, linguistic barrier is yet another major barrier towards the success of a merger.

2.4 Models to test merger:

There are different tools or models that can be used for testing the suitability of a firm prior to merger. However, the major types of tests are discussed below:

- **Industry attractiveness test**
- **Net Present Value test**
- **The "Better-Off" test**
- **The integration test**

The above mentioned tests help in judging the potential benefits that firms can expect from a merger however Net Present Value (NPV) test and Industry attractiveness test are the most popular ones as the former helps in identifying the future prospects & growth opportunities whereas the later indicates the expected net financial outcome from the merger.

These two tools are discussed below:

Industry attractiveness test:

Industry attractiveness test is concerned with evaluating the future prospect of a concerned industry in which a firm belongs (Smith and John Maynard 1998). This test helps in identifying the growth prospects of a firm in future while operating in a particular industry. The key focus of this test is on potential opportunities and threats associated with a given market based on which the price of merger is determined. In other words, this test is based on the potential profits and revenues that can arise because of growth prospects of a particular industry. Therefore, higher the growth prospect of an industry greater is the purchase or merger price.

NPV test:

NPV refers to the difference between the present value of future cash inflows and future cash outflows. Thus, NPV is the present value of net cash flows that can be expected in future. The key benefit of NPV model is that it considers the time value of money and thus indicates the discounted value of future income. However, Smith (2005a) viewed that selection of a discount rate is one of the most difficult tasks in context of NPV method and the chosen discount rate might not be the same in future which can result in increase or decrease of net benefits acruing from a merger.

One of the major reasons for the failure of merger is that a firm often pays more than it should be towards the business of the other firm. NPV model suggests that the net financial benefits expected from a merger needs to be more that the price paid by a firm for merger. As suggested by Porter, for a merger option to be acceptable, the NPV has to be above zero for the target company to clear this test.

2.5 Merger of Singapore airlines and Virgin Atlantica:

The merger between Singapore Airlines and Virgin Atlantica has been one of the most remarkable one in the airline industry at international level. The merger between the two companies seems to be because of the focus on network expansion. In fact, this is the most common reasons for which airline companies enter into merger with each other. However, another common reason could for the airline companies to enter into a merger is to eliminate a competitor from the market by entering into business partnership. The merger between Singapore airlines and Virgin Atlantica seems to have resulted in increased bargaining power of the companies over the suppliers, improved brand equity, higher sales revenue because of joint sales force and cost reduction due to mutual resource sharing.

2.6 Financial summary:

SL	Items	Singapore		Virgin	
		2014	2013	2014	2013
1	Net Profits	424.40	441.60	2927.9	2570.6
2	Revenues	15243.90	15098.20	14.9	0.3
3	Total assets	17251.00	17026.10	1218.3	1172.9
4	Equities	13237.20	13089.50	2	71.2

5	Current assets	7310.70	7499.50	719	775.1
6	Current liabilities	5391.40	5401.60	1065.3	935.4
7	Current Ratio	1.36	1.39	0.67	0.83

The figures doesw not indicate any significant improvement in the financial position of both the companies in the merger. The net profit of Singapore airlines has fallen considerably in 2014 compared to the same in 2013 whereas the net profit for Virgin has increased marginally in 2014 than that of 2013. On the other hand, the liquidity position of both the company has taken a downturn in 2014 compared to 2013 as indicated by the current ratio. However, the total assets of both companies have increased marginally in 2014 compared to the same in 2013. On the other hand, it is interesting to note that the equities of Singapore airlines has increased in 2014 compared to 2013 whereas the equities of virgin has experienced sharp decrease in 2014 than that of 2013. This can be attributed to the sale of 49% stake of the company to Singapore airlines.

3.0 Methodology:

This section of the study briefs on the methodology adopted by the researcher for testing the case of merger under consideration.

3.1 Research type:

Research studies can be classified into quantitative, qualitative and mixed research types. Each of these research type has its own benefits and limitations. However, the researcher in current scenario uses mixed research style by considering both financial and non-financial aspects during the study. In other words, the researcher gathers and analyses both quantitative and qualitative data during the study. This helps in improving the quality of research outcomes.

3.2 Research approach:

Research approaches can be broadly classified into inductive and deductive approaches. Inductive approach seeks to develop a new theory or view based on the review of current situation whereas the focus of deductive approach is on examining the validity of current views and theories.

The researcher follows deductive approach for the current scenario as the study is principally aimed at understanding the real life benefit from the merger of the two firms under consideration.

3.3 Research design:

Research designs are mainly of three types which are exploratory design, explanatory design and descriptive design. The current study would pursue exploratory research design as this allows the researcher to analyse the merger deal between the two companies from different perspectives.

3.4 Data type:

Data are simply the facts and figures that are rw in nature. It means that the data are the unprocessed and unorganised form of facts and figures. Data when processed give rise to information which are useful in arriving at certain decisions. Data can be basically classified into primary and secondary data. Primary data are obtained from the sources and thus are original in nature. On the other hand, secondary data are the ones that are not collected from original sources but from such sources on which primary data analysis has been conducted already.

The researcher uses only secondary data for the current study. The researcher collects financial data from the annual reports of the chosen companies.

3.5 Testing process / Key financial indicators:

The researcher mainly use ratio analysis to test the actual benefits derived from the merger of the companies under consideration. The key ratios or financial items considered by the researcher for evaluating the financial benefit from the merger are mentioned below:

Earnings per share:

Earnings per share is obtained by dividing the total earnings of a firm by the number of outstanding shares. Earning per share indicates the net profit per share.

Net Profit margin:

Net profit margin is obtained by dividing the net profits by the sales of a company. Net profit margin is the ratio of the net profits of a firm to the sales revenue. It indicates the profitability of the firm.

Assets to sales ratio:

Assets-to-Sales ratio or asset utilisation ratio indicates the extent to which a company has been able to utilise its assets to generate sales revenue from the same.

Current ratio:

Current ratio is an indicator of the liquidity or short-term solvency position of a firm. The ideal current ratio for a company is considered as 2:1 however the same can vary in accordance with industries. Current ratio is the ratio between the current assets of a firm to the current liabilities.

Total assets:

Total asset is one of the most common measure of the worth or business value of a firm. Total assets comprises of two main elements which are current assets and fixed assets. Higher the amount of total assets better it is for any company.

Net Worth:

Net worth is the difference between the total assets of a firm and the external liabilities or debts. In other words, net worth is the equity of a company that represent the excess of total assets over the debts of a firm.

3.6 Research limitations:

The key limitation of the current study is its sole dependance on secondary data. The study does not consider primary data in the investigation process. However, views from managers of singapore airlines and virgin atlantica coudl have helped in gaining useful insights on the merger and its impact on these two companies as perceived by the management.

4.1 Limitations:

Thus, it is observed from the above analysis that the merger between Singapore airlines and Virgin Atlantic has not resulted in any significant financial benefit to any of the two companies. Therefore, doubts raise over the actual benefit derived by these companies through the merger. In fact, reduction in liquidity of both the companies has been a major concern for these two companies.

4.2 Recommendations:

The following recommendations have been developede for both Virgin Atlantic and Singapore airlines to derive better outcomes from the merger:

Implementation of BSC approach:

Balanced Score Card approach can help both the companies in developing relevant Key performance indicators (KPIs) and track the performance against the developed targets. In addition, BSC approach can help in identifying performance deviations by comparing actual performance against the set standards.

Focus on cost reduction:

Singapore Airlines and Virgin Atlantica needs to focus more on reducing internal costs. This can be done through the application of various cost optimisation techniques like JIT inventory system and others. This could help in increasing the profitability percentage to the companies. Regular identification of non-value adding activities and elimination of defectives can help on this.

Business expansion in other countries:

The revenues of both these companies can be further increased by focusing on expansion in developing countries. In other words, these companies need to concentrate on entering into markets that are still un explored by working together.

5.0 Conclusion:

The merger between Singapore airlines and Virgin atlantica might have fetched certain strategic advanatges to both the companies but financial returns from the same has been quite poor. On the contrary, the liquidity position of the companies have decreased in 2014 compared to 2013 thereby creating a concern for both the companies. Therefore, it is high time for both these companies to develop alternative strategies to mitigate the issues or poor financial return.

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