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Cross Border Acquisition of JLR: A Boon or Pain for Tata Motors

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Abstract

The trend of mergers and acquisitions (M&A) has seen a surge during the past decades. The strategy of mergers and acquisitions has also been adopted by Indian companies for their expansion & growth. It facilitates the corporations in gaining competitive advantages and increase in their shareholder's wealth. The study to date analyzed both inbound and outbound deals and M&A's positive or adverse impact on a company. Studies conducted in the past showed that the rate of unsuccessful mergers and acquisitions were more in number than the successful ones.

This paper attempts to evaluate the effect of Earnings before Interest and Tax (EBIT) of Jaguar & Land Rover (JLR) on share prices of Tata Motors. Tata Motors is an Indian conglomerate automotive company of Tata Sons based in India and also the parent of JLR. Tata Motors has acquired JLR, a British multinational automotive company, in 2008 for $2.3bn.

The study has taken price movement of the share of Tata Motors on NSE for the year 2008 to 2018 and correlated it with the corresponding years' EBIT of JLR which significantly contributes to profits of Tata Motors in the form of dividends. 13 weeks price moving average of Tata Motors on NSE is taken as one set of variable and quarterly EBIT of JLR is taken on another. The study has also taken into consideration various macroeconomic factors that would have had an impact on the performance of JLR and in turn on the prices of Tata motors. This study found that the EBIT of JLR is positively correlated with the share price of Tata motors.

Keywords: Acquisition, Earning Before Interest and Tax, Share Price, Correlation.

JEL Classification: G15, G20.

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1. Introduction

1.1 Merger and Acquisition: A scintillating phase in today's corporate world

Unlike steady but slow result oriented organic growth, M&A (an inorganic mode) has become the easiest mode to achieve objectives of the firms. Adoption of inorganic mode facilitates CEOs and in turn management of the company to create value for their shareholders by resorting to those policies which enhances the share's market price through increased synergy and achievement of cost benefits.

Today's corporate scenario is a plethora of mergers and acquisitions activities. There has been, in the past decade, a trend of merger and acquisitions (M&A) in India as well. According to the CII-PwC report, there have been over 600 to 750 acquisitions of Indian companies and over 3400 mergers and acquisition in all, in both public and private domain, in the last decade [1].

Mergers and acquisitions are used as synonyms for each other but there is a distinction between the two. A merger happens when two companies combine and become one company and acquisition takes place when a company takes control of another company by acquiring its assets entirely.

Mergers and acquisitions render their advantages in the form of growth, competitive advantage, synergies, and market expansion of the companies involved in M&A. Mergers and acquisitions can be both inbound as well as outbound. Indian M&A scenario has witnessed both varieties of deals in past decades. One significant aspect was that both inbound as well as outbound deals, in India, were almost equal in numbers as well as in terms of values.

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M&A is one of the most convenient mode to expand market internationally. This study is based on one such outbound acquisition of Jaguar and Land Rover by Indian conglomerate Tata Motors of Tata Sons. Tata Motors acquired two marquees Jaguar and Land Rover from Ford in the year 2008 for a price of US $2.3 billion [2]. After the acquisition, the wholly owned subsidiary was named Jaguar Land Rover [3]. Tata Sons, through the acquisition of the two marquees, aimed to expand the brand name of Tata motors internationally. Entry into the luxury cars market segment, to cater to high end purchasers based in India was also one of the substantial benefits that captured the interest of Tata Sons. Tata Motors was mainly engaged in the production of trucks, buses as well as low budgeted cars in India before the deal. The management wants to diversify geographically through this acquisition

1.2 Teething troubles faced by Tata Motors and Jaguar Land Rover: Bottlenecks in Integration Process of M&A

1.2.1 The Recession Impact

In 2008, the year of acquisition of Jaguar and Land Rover by Tata Motors, the worldwide recession and low consumer spends had a major impact on this deal. At start of this downturn in the economy, cars have raced to the top of most people's lists *of what not to buy*. Peoples, who would like to buy a new one, were unable to scrounge the money- which is how most purchases are financed. As an upshot the production of British vehicle had dropped by 33 percent in November 2008 as compared to the previous year, and the registration of new passenger cars across Europe knock down to 26 percent.[4] The consequence of the recession was that in the year 2008 the company reported a loss of £ 400 million.[5] With the launch of new model Jaguar XJ of Jaguar and Discovery and the Range Rover Sort of Land Rover sales bounced back though marginally.[6]

1.2.2 The BREXIT Impact

The year 2008- 2015 were tough for Tata's management to manage the business in Europe. In 2016, BREXIT caused a deep-rooted impact on the profits of JLR owing to levy of heavy customs and Import duties. In India, reports of the adverse impact of Brexit on Tata Motors' UK subsidiary spooked the already worried investors. After touching the fresh 52-week low of Rs 252.55 in the intraday trading, the stock of Tata Motors closed at Rs 261.50, down 2.06 percent. Tata Motors' stock has stabbed 39.36 percent to Rs 261.50 from a previous high of Rs 431.20 in December 2016 and continuously underperformed the benchmark Sensex and auto index since then.[7]

JLR was catering as a luxury car manufacturer in its home market in the UK and European Union (EU) as a single market till the time BREXIT happened But with UK's decision to exit from the EU, this status was changed for JLR. When the free trade was disbanded after the BREXIT, an Import duty had been levied on JLR and the other UK based manufacturing companies by the European Union. This severely had an adverse impact on JLR's profit margins and its cash flows.[8]

1.2.3 US-CHINA Trade War Impact

The US-China trade war has drastically hurt JLR's sales as China and US was a significant market for JLR. This further pulls down Tata Motors' performance.

On 8 October 2018, JLR proclaimed that its global sales fell by 12% in September 2018; around 46% stab in sales in China was largely owing to the uncertain economic fluctuations and weak consumer demand. With US-China trade war as a backdrop and import duty changes Tata –JLR deal and balance sheet juggle between red and green.[7]

Tata Motors, the largest automobile manufacturer of India by sales, testimonies a loss in the second quarter of September 2018 slanted down further by the weak performance of Jaguar and Land Rover, which contributed to the mass of its earnings to Tata Motors as a dividend. Tata Motors was knocked by ebb and flow of political events internationally, particularly, the continuing trade war between the US and China was the prominent reason.

JLR was held responsible for the slow down on "multiple challenges". This includes the change in import duties of China to cut off import tariffs on automobiles to 15 percent from 25 percent from 1st July 2018 which results further lowering down the sales of JLR. Quarter ending June 2018, Jaguar Land Rover made a £264m pre-tax loss, compared to a £595m profit last time around the same period. Total sales fell by 6.7% year-on-year basis to £5.2bn. [9]

In the year 2017, there was an increase in sales thrice as compared to 2009 due to the introduction of new and efficient engines by JLR. China is among the biggest market for JLR in the luxury car market but the sales decreased in the second quarter of the year 2018 due to the long drawn and stretched US-China trade war

2. Objective of The Study

The main purpose of this paper is to examine whether the Earnings of JLR affects the share price of Tata Motors. From the very beginning, the acquisition of the two marquees has affected the share price of the Tata motors. It is evident from the fact that in the financial year 2008-09, due to recession, there was a loss of £400 million from JLR accruing to Tata Motors and as a result of it in 2009, for the first time, the share price of Tata motors were at its lowest of Rs 126.45 since inception signaling acquisition as a costly affair for Tata Sons.

In the year 2017, the shareholders of Tata Motors in India started raising their voice against non-declaration of dividend by Tata Motors management despite the fact JLR reaping benefits overseas.[10] This event directly reflects the expectations of shareholders in India from that of JLR profits have a direct impact on Tata Motors as a substantial portion of profits comes from JLR as a dividend. In yet another event in 2017 that caused the share price of Tata Motors to rise by 3% is when the company's management in India declared that it has no plans to list JLR and Tata would continue to fund JLR operations on its owns.[11] All these are non-empirical evidence and needs to be quantified.

3. Literature Review

There are various financial and strategic objectives that influence mergers and acquisitions. Business organization literature has identified two common reasons which are derived out of mergers and acquisitions i.e. efficiency gain and strategic rationale (Neary, 2004). Past work concerning the return to shareholders of both the acquired company and the target company (Jhon Doukas,Nickolaos G Travlos,1998) found out that the shareholders of the US companies that acquired foreign companies for the first time gained abnormal positive return which was not so significant and the already existing multination companies in the target countries noted negative returns which were insignificant as well. It also stated that the acquirer company market value also increased from the expansion in the multinational market. Another study reviewed the empirical research on the impact of acquisitions on firms' performances by (Christian Tuch, Noel O'Sullivan, 2007). The study found out that in short run acquisitions have an insignificant impact on shareholders wealth and in the long run, performance analysis shows a negative return. The work also took into consideration the impact of circumstances of bid on performance. It states that the attributes associated with better performance of acquisitions are outbound acquisition, cash payment made for acquisition and acquisition of a larger target. It also examines the acquirer that had superior performance before the acquisition period had underperformed after the acquisition. N Sinha, KP Kaushik, T Chaudhary (2010) in his paper 'Measuring Post Merger and Acquisition Performance: An Investigation of Select Financial Sector Organizations in India' examines the impact of M&A on the financial efficiency of the selected financial institutions in India by using two-stage analysis –ratio analysis and nonparametric Wilcoxon signed rank test during the period of 2000-2008 to find a significant correlation between financial performance. But to analyze the impact of cross border situated subsidiary's performance on the market capitalization of holding in another country, considering dividend cash inflows accruing to the holding company (also the acquirer) as a key catalyst, remained unstudied. This work intended to fill that void.

HM Lee, CC Lee, CC Wu (2011) in their work 'Brand image strategy affect brand equity after M&A' examines the relationship between the variance of two brand images and dimensions of brand equity after M&A, especially, when the acquirer-dominant is affiliated to a weak brand image and the acquired one has a stronger brand image. In this study 409 responses were collected through random sampling from an internet survey platform in Taiwan This study also examines how brand equity of an acquired brand changes after M&A. MANOVA and paired-sample t-test methods have been used to show that the greater the perceived differences between acquirers and acquired brands, the more the brand equity of the acquirer will increase. A study involving four Indian Banks analyzes the effectiveness of mergers and acquisitions in the Indian banks. The analysis was done by taking five years each before and after the amalgamation. The effectiveness of amalgamations was analyzed by considering profitability, liquidity and solvency ratios of the banks through SPSS. It was founded that amalgamations do not enhance the companies' profitability significantly (Abhay Raja 2016).

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Abdulazeez DA, Yahaya OSA (2016) examines the impact of mergers and acquisitions on the financial performance of some selected deposit money banks in Nigerian from 2002 to 2008. The study analyses Returns on Asset (ROA) and Return on Equity (ROE) to measure the financial performance of the banks before and after consolidation. T-test was used to analyze the data and founds that bank witnessed improved and robust financial performance owing to merger and acquisition leading to more financial efficiency in the Nigerian banks. Another study conducted by Dwa, Sajena & Shah, Ajay. (2018) titled 'A Study on Merger and Operating Performance of Commercial Banks of Nepal' examines the impact of mergers on the operating performance of sample merged banks. Eight independent variables; operating profit margin, net profit margin, return on assets, return on equity, debt-equity ratio, return on loan loss provision, return on staff expenses and return on operating expenses. In order to examine whether the merger has led to a profitable situation or not, work mainly focuses on quarterly secondary data which was analyzed using paired sample t-test, correlation analysis, VIF test, and regression analysis. From the analysis, it was deduced that merger has no significant role in case of Nepal Bangladesh Bank and NIC Asia Bank in terms of various operational ratios since many operational ratios have been found weaker in post-merger period than pre-merger period.

Another work titled Mergers and Acquisitions within the Tata Group, 2018 examined the consequence of going global through mergers and acquisitions and the stock trader's long term and short-term earnings respectively. The study facilitates to analyze the impact on companies' financials post M&A. It also determined the enterprise value of the corporation by comparing it with the peer group and studying the value of the firm.

4. Research Methodology

4.1. Research Design:

In this study ex-post facto research design is used. Ex post facto study or after-the-fact research is a sort of research design in which the analysis starts after the fact has taken place without intervention from the researcher. Previous data relating to the subject theme will collect to establish the correlation between the phenomenons under study.

4.2. Data Collection:

Data for this study were quantitatively retrieved from the annual reports of JLR automotive plc and Tata Motors. The EBIT is unruffled on a quarterly basis from the official site of JLR and the share prices of Tata motors are taken from National Stock Exchange (NSE).[12] On a daily basis, closing share prices are considered in this study and then they are averaged quarterly. This represents a more reliable data rather than share price taken off a day of the quarter or of the last month.

4.3. Period of Study:

The data of both EBIT and share prices are composed from three financial years i.e. from 2008-2009 to 2017-2018. The data has been collected on a quarterly basis.

4.4 Tools Used:

In order to find whether there is a relationship between the EBIT of JLR and share prices of Tata motors, a statistical tool correlation has been used. The type of correlation used in the study is Karl Pearson's coefficient of correlation. This method of correlation is used to calculate the degree and direction of the relationship between two variables.

To test the significance of the hypothesis framed, Z- test has been used because the sample collected is more than 30. A z-test is a statistical test used to determine whether two population means are different when the variances are known and the sample size is large. The test statistic is assumed to have a normal distribution, and nuisance parameters such as standard deviation should be known in order for an accurate z-test to be performed. [13]

1. Hypothesis Testing:

The following hypothesis has been primed during this study.

Null Hypothesis H_0: There is no significant upward correlation between operating profit of JLR and share prices of Tata Motors.

II. Alternate Hypothesis H_1: There is a significant upward correlation between the operating profit of JLR and share prices of Tata Motors.

2. Findings:

As it can see that in **Table 1** depicted below, there is a positive correlation between EBIT of Jaguar and Land Rover and Market Share Price of Tata Motors i.e. 0.66 which is positive. This correlation has been derived by using MS Excel statistical tool. Therefore, the hypothesis that we have established is true.

Table 1. Computation of Co-relation between EBIT of JLR & Share Prices of Tata Motors

Year	Month	Operating Profit in €	Exchange Rate	Operating Profit in Rs	Share Price TOTAL	No. of days	Average
2008-09	June	-100	66.78	-6678	6974.2	61	114.33
	September	-100	65.87	-6587	5112.8	64	79.89
	December	-100	64.19	-6419	2145.8	59	36.37
	March	-100	64.78	-6478	1768.6	59	29.98
2009-10	June	-12.5	66.31	-828.875	3557.5	59	60.29
	September	-12.5	69.03	-862.875	5597.4	64	87.45
	December	-12.5	68.78	-859.75	7444	61	122.03
	March	-12.5	63.55	-794.375	8892	60	148.2
2010-11	June	259	58.04	15032.36	9747	63	154.71
	September	260	59.96	15589.6	12098	65	186.12
	December	296	61.48	18198.08	15345	64	239.77
	March	299	60.57	18110.43	14157	62	228.39
2011-12	June	251	64.27	16131.77	13828	62	223.03
	September	216	64.64	13962.24	10569	63	167.76
	December	509	68.35	34790.15	11038	60	183.97
	March	530	65.82	34884.6	15543	64	242.86
2012-13	June	333	69.25	23060.25	16936	63	268.83
	September	431	68.96	29721.76	14968	63	237.59
	December	404	70.25	28381	16677	61	273.39
	March	507	71.49	36245.43	18483	62	298.11
2013-14	June	415	73.02	30303.3	18039	63	286.33
	September	668	82.4	55043.2	18987	63	301.21
	December	842	84.42	71081.64	22829	62	368.21
	March	576	84.59	48723.84	24129	63	383
2014-15	June	924	82	75768	25486	60	424.78
	September	609	80.24	48866.16	29886	63	474.34
	December	685	77.32	52964.2	29341	58	505.88
	March	396	70.09	27755.64	33594	62	541.84
2015 - 16	June	638	70.16	44762.08	30027	62	484.3065
	September	-157	72.31	-11352.67	23145	64	361.6406
	December	499	72.16	36007.84	23566	61	386.3279
	March	577	74.51	42992.27	20757	61	340.2787
2016-17	June	399	75.53	30136.47	25995	62	419.2742
	September	280	74.38	20826.4	32028	62	516.5806
	December	255	72.54	18497.7	30776	63	488.5079
	March	676	71.34	48225.84	30414	63	482.7619
2017-18	June	595	70.94	42209.3	27656	62	446.0645
	September	385	75.56	29090.6	26178	64	409.0313
	December	192	76.22	14634.24	26129	62	421.4355
	March	364	79.14	28806.96	22918	60	381.9667
Correlation				0.663819246			

From **Table 2** depicted below we have Mean, Median Standard Deviation, sample variance, Kurtosis, and Skewness of 40 sample observations which is calculated by using solver tool of MS Excel

Table 2. Mean, Median, Standard Deviation, Variance for both EBIT of JLR and Average Share Prices of Tata Motors

Operating Profit In Rs		Average	
Mean	25248.57013	Mean	295.1709
Standard Error	3421.03547	Standard Error	23.4859
Median	28068.32	Median	292.22
Standard Deviation	21636.52809	Standard Deviation	148.5379

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Table 2 (cont.). Mean, Median, Standard Deviation, Variance for both EBIT of JLR and Average Share Prices of Tata Motors

Sample Variance	468139347.6	Sample Variance	22063.49
Kurtosis	-0.329399144	Kurtosis	-1.11575
Skewness	0.210266199	Skewness	-0.12714
Range	87120.67	Range	511.86
Minimum	-11352.67	Minimum	29.98
Maximum	75768	Maximum	541.84
Sum	1009942.805	Sum	11806.84
Count	40	Count	40

From the **Table 3** it can be seen that after applying Z-test for two samples mean we had found that the computed value of |z| is 7.56 which is greater than the critical value (t = 1.96) for two tail and (t = 1.64) for one tail. This critical value has been taken at a 5% level of significance and 39 degrees of freedom. It falls in the Rejection region. Hence the null hypothesis is rejected and it may be concluded that there is a significant upward correlation between the operating profit of JLR and share prices of Tata Motors.

Table 3. z-Test: Two Sample for Mean

	Operating Profit In Rs	Average
Mean	25248.57013	295.1709058
Known Variance	468139347.6	22063.49
Observations	40	40
Hypothesized Mean Difference	0	
z	7.29393525	
P(Z<=z) one-tail	1.51E-13	
z Critical one-tail	1.644853627	
P(Z<=z) two-tail	3.01E-13	
z Critical two-tail	1.959963985	

Conclusion

This study pragmatically observed that merger and acquisition is the most significant means of going global for Tata Motors as its whole share prices ebb and flow with the operating profit of it's subsidiary JLR. From the study, we have concluded that there is a significant upward correlation between the operating profit of JLR and share prices of Tata Motors. The success or failure of merger and acquisition to a large extent depends upon the financial potency of the merging unit. Merger can be successful for those units that have harmonizing financial position with its target allies and failure for those which had to bear the financial encumber of its target allies,

As in this study, we have found that there is some impenetrability like economic impact, trade war, hike in price of diesel, due to which the share prices of merging company i.e. Tata motors, fluctuate with the fluctuation in operating profit of target company i.e. JLR. Hence when a company is acquired by another company it becomes an integral part of it and if the target the company gains the acquirer company gains and in the same way if the target company incurs a loss the acquirer company has to bear it too. Whether the financial performance of the target company affects the overall results of the acquirer company, in the form of profits or market value, depends on the question is the target company that significant part of the acquirer company to effect it or not?

Future Implications of The Study

This topic is cooperative for management/commerce post graduate students to understand the concept of merger and acquisition and its effect. It is interdisciplinary and related with the economic impact in one country and another in empirical manner. This study helps in looking at the cross-border acquisition with a new perspective. This study looks at the merger & acquisition deals from a fundamental analysis point of view. The investors of Tata motors can take their decisitions on the basis of the performance of Jaguar Land rover i.e. the subsidiary company and on the basis of which they can decide to hold, purchase or sell the shares and prepare their portfolio accordingly. It can be implemented in the case of other companies too.

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