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Impact of mergers and acquisitions in telecom industry: An analytical study of financial performance of Vodafone Idea limited

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Abstract

The telecommunication sector has witnessed increased mergers and acquisitions since 2017. This transformation has led to severe competition in the industry. The research work focuses on the merger deal that happened between Telecommunication companies Idea cellular and Vodafone India highlighting the changed strategies adopted by them. This paper also provides a comprehensive view of the current financial position of the company as of 2023. The deal was officially announced on 20th March 2017 for total of \$23 billion. The merger changed the market dynamics entirely and Idea-Vodafone became market leader with maximum number of subscribers and left Airtel on second position. The merger deal took place due to various reasons but major reason behind this deal was entry of Reliance Jio. The financial statements of both companies before and after the merger helped in deriving interpretations and findings to understand where Voda-Idea stands today.

Keywords: Mergers, acquisitions, financial statements, Vodafone-Idea

1. Introduction

In today's corporate world, the process of mergers and acquisitions has gained a meaningful importance extensively used for restructuring the business sector. In India, the process of mergers and acquisitions has been initiated by government bodies. The Indian Economic Reforms 1991 have opened the sphere for both domestic as well as International market. The increased competition has led Indian companies to go through this process as an important strategic framework in the global market. An immediate effect has also been noticed in the Indian economy across numerous sectors.

Even though mergers and acquisitions have become an important element in developing corporate strategy all over the globe for several decades but still research has not been able to provide conclusive evidence that whether they enhance efficiency or destroy wealth. There is an ongoing special debate on the benefits and setbacks of mergers and acquisitions on the firms. The main motive behind mergers and acquisitions is to create synergy; that is, one plus one is more than two and this rationale attracts companies towards merger activity during times of difficult business situations (Agarwal Manish 2003) ^[10].

Merger and acquisitions activity helps companies to secure the benefits of greater market share and cost efficiency and these benefits are demonstrated by the superior post-merger performance of the acquiring entities (Pandya 2012) ^[11]. Mergers can be broadly classified into:

Vertical Merger

It's done to combine two companies that provide similar or common goods or services, in an effort to bring together different supply chain functions that either organization might operate with.

Horizontal Merger

Horizontal mergers are a little different. Where a vertical merger operates between two companies that may not happen to be competitors, a horizontal merger will operate between two or more companies that are competitors.

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Conglomerate Merger

This is a merger or acquisition that takes place between organizations that have totally unrelated business activities.

2. Objectives

- To examine the presence of benefits and set backs of merger and acquisitions.
- To study the financial performance of Vodafone post-merger.

3. Research Methodology

3.1 Data Collection

Secondary Data: The data collected from readily available sources which helps in further processing of information is called secondary data. The data for the research is based on secondary data. The financial statements were taken from the published data i.e., company's official websites, money control and zee business.

3.2 Scope

The scope of the research is based on data of three years pre-merger (2016-17, 2017-18, 2018-19) and three year's post-merger (2020-21, 2021-22, 2022-23).

4. Benefits of Mergers

A merger is a combination of two or more entities presenting an effective strategy for company's expansion. Generally, the motives of mergers are to enhance the competitiveness of a new combined entity in the form of synergies, growth and new revenue streams that can improve bottom-line profitability. It is generally achieved through stock exchanges or outright payments to other companies. The grounds behind business consolidations may vary and range from an increased market share to International expansions.

Tax Benefit

A company with a large taxable income would look towards merger with a company having large carry forwards tax losses. By doing so, the acquiring company can lower the tax liability. Regulators will not approve a merger purely for reducing tax liabilities. However, companies hide this reason under other strong motivations to merge.

Personal Incentives for Managers

The company executives might want the merger to satisfy their personal motives rather than maximize the shareholder's value. After post-merger the bigger company translates into more prestige and greater power for them. Even the compensation rises in a bigger company. Thus, the managers prefer the merger to increase the size of their company.

Rapid Growth

Generally, every company has two options towards growth: organic growth or external growth. Organic growth is achieved by increased sales through making internal investments. External growth is achieved by increasing sales through investing in external resources. This is done by mergers and acquisitions. Often companies prefer growing externally, especially the ones in a mature industry as the industry offers limited opportunities for growth. It is always less risky to have external growth.

Diversification

Diversification of products and services are the long term prospects of every business. A target business may be able to offer variety of products or services that one can sell through its own distribution channels.

Unlocking Hidden Value

A struggling company may be taken over by an appropriator to unlock its hidden value. The acquiring company might believe that making necessary improvements in management, organizational structure and while adding more resources, it can make the company perform better. Of course, the discoverer will be willing to pay a lower price than the market price.

International Goals

International mergers and acquisitions have become more common in today's business world, likely in one's own country. International deals are also motivated by the below mentioned reasons. There are several reasons specifically for International Mergers:

- Distinctive products can be marketed in new markets.
- Transmission of technology to new markets.
- Exploiting market incompetency.
- Overcoming detriment policies of the government.
- Continued aid to international clients.

5. Setback

Raises prices of Products or Services

A merger results in reduced competition and a larger market share. Thus, the new company formed gain a monopoly and increase the prices of its products and services.

Increased legal costs

Merger of two companies often require involvement of several key professionals that assist with the assets and other financial details. The legal costs associated with mergers and acquisitions can be high.

Creates gaps in communication

The companies that have agreed to merge may have different cultures. It results in a gap in communication and affects the performance of the employees.

Creates unemployment

In an aggressive merger, a company may opt to eliminate the underperforming assets of the other company. It may result in employees losing their jobs.

Prevents economies of scale

In cases where there is little in common between the companies, it may be difficult to gain synergies. Also, a bigger company may be unable to motivate employees and achieve the same degree of control. Thus, the new company may not be able to achieve economies of scale.

6. Parties Involved

6.1 Idea cellular ltd

Idea cellular ltd was an Indian mobile network operator based at Mumbai, Maharashtra. It was a Pan-India integrated GSM network offering 2G, 3G, 4G services having a 220 million subscribers as of June 2018 with a market share of 16.70%. Idea cellular market capitalization as of March 2018 was around Rs.35, 744 cr. It is listed on

both National Stock Exchange and Bombay Stock Exchange. Founded in 1995 with a partnership of Tata Group and AT&T. Nowadays Idea is controlled by Aditya Birla Group. Kumar Mangalam Birla is a renowned businessman and the chairman of Aditya Birla Group.

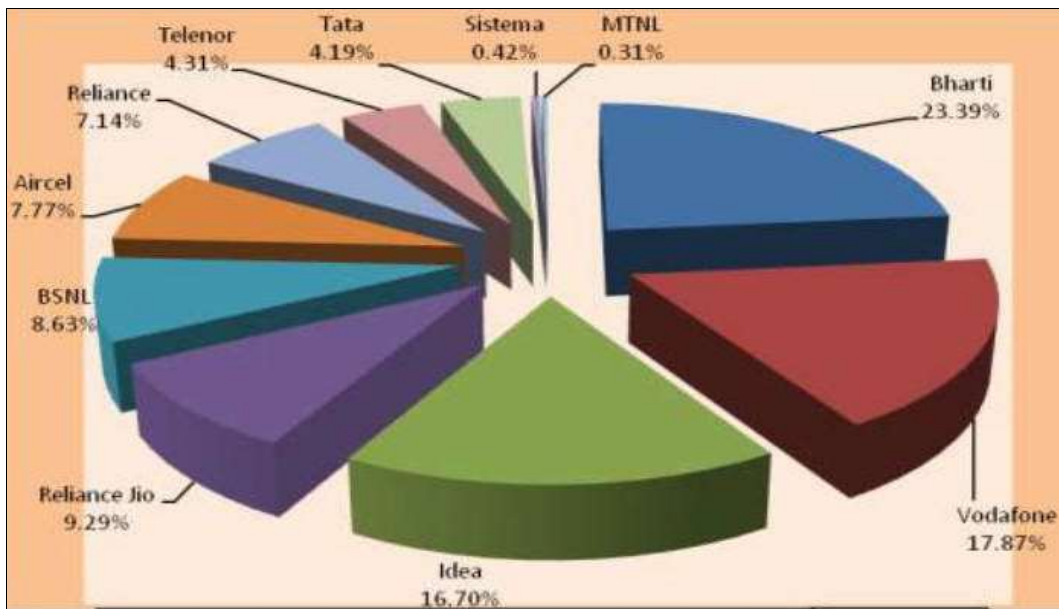
6.2 Vodafone

Vodafone started its operations in 1985. It is one of the world’s leading telecommunication companies based in London. Vodafone group entered in India in 2007 through a subsidiary based in UK. Shares of Vodafone are traded on London stock exchange and NASDAQ. Vodafone India has a market share of 21% as of March 2018 and after the merger with idea, Vodafone-idea network now has approximately 375 million members. This has made it

India’s third largest cellular mobile provider.

6.3 The Vodafone-India Merger

On August, 2018 the merger of two telecom giants Idea Cellular Limited and Vodafone Limited was finalized- thus creating Vodafone-India limited. The merger was announced on March 20, 2017 wherein Idea Cellular Limited, the third largest telecom company in India announced a USD23 Billion deal with the second largest telecom operator, Vodafone India Ltd for improving financial and operational efficiencies. The merger was triggered by the entry of Reliance’s Jio Infocomm Limited (JIO) in September 2016 with a disruptive pricing strategy- changing the face of the Indian Telecom Industry.



Source: <https://www.telecomlead.com/telecom-statistics/airtel-jio-wireless-market-share-march-2017-76876>

Fig 1: Post Jio Market Shares (March, 2017)

Thus, the financial distress along with the consistent pressure of maintaining profitability paved the way for consolidation. It was at this point when Idea Cellular Ltd and Vodafone India Ltd announced their merger becoming the largest player by revenue and market share.

The merger is a type of horizontal merger where both the companies operating in the same space and industry merge to create improvement of efficiencies. The merged entity had a revenue market share of 32.2% and customer market share of 41.1%. It also encompassed 1.7 million retail outlets and 50,000 channel partners and the widest footprint of 15000 stores.

(Million)

Year	2017	2018	2019
Total Revenue	36,304.50	28,954.30	42,157.00
EBITDA	10,973.84	6,575.30	5,905.30
PBIT	3,146.64	-1,651.80	-8,630.20
PBT	-863.23	-6499.20	-18,175.40
Net Income	-399.69	-4,168.20	-14,603
EPS	0.67	-6.32	-18.31
DPS	0.00	0.00	0.00
Payout ratio	0.00	0.00	0.00

7. Strategy followed by Idea-Vodafone

The following strategies were adopted by the two companies to facilitate smooth functioning of the merger and to make sure to create value for all the parties involved, not to penalize any particular stakeholder.

- The Vodafone group offered ‘golden handshakes’ i.e. handsome packages to the best performing employees who were likely to be accommodated post-completion of the merger.
- The companies planned to reduce debt burden through rationalization of tower tenancies- Indus tower shakes. This whole move expected to create a synergy of USD 10 Billion.
- The companies decided to create a common work culture and ethics and focus on external battles.
- The company offered retailers and distributors higher incentives to sell subscription plans. Pre-merger the usual rate of commission was 70-80 Rs for a plan which increased to 17-180. Thereby attraction new subscribers to choose Vodafone-Idea over other operators.
- Both the companies operated in their areas of strength- Vodafone being dominated in urban sector and idea in rural sector. Both the brands retained their dominance in home markets.

8. Benefits Expected

- The merged entity became India’s largest telecom operator with a subscriber base of more than 400 million subscribers and a market share of more than 35.61% replacing Airtel.
- Both has a defined and different segment of customers and hence a wider reach while becoming a single unit.
- Measures of cash generation such as selling Indus tower stakes could aid in reduction of net debt from 4.4 to 3 times of the merged company.
- Merged entity has 1850 MHz spectrum across multiple brands. Airtel having 1692 MHz and Jio having 1310 MHz. Thus having a higher network capacity for the new entity.
- 1.7 million Retail outlets and a huge broadband network of 3, 40, 000 sites ensured the maximum reach to customers.
- The company to become the second largest telecom operator in subscriber base after China Mobile Communication ltd.
- Infrastructure sharing would result lower cost.
- Improved new services like integrated digital services including voice, data mobile payments.

9. Challenges of the Merger

Despite the many expectations being created out of the merger, the merger is still being criticized on the grounds of lack of motivation and no definite strategy between the combining parties.

- The pricing strategy adopted by Reliance Jio was the biggest threat to the combining entity. Jio offering content for free had a major impact on revenues of Vodafone-Idea.
- Manpower- a key asset would be cut down post consolidation to reduce costs and add assets to balance sheet.
- The countrywide network integration would be costly due to redeployment of network in uncovered and territories as well as restructuring of long term contracts with previous partners might attract penalties.
- The integration of cultural differences i.e. staff working with a foreign MNC versus a home grown firm.

Overall there was nothing new or unique about the deal. Both the parties provided good services without having any aggressive business strategies in the initial days.

10. Financial Performance Post Merger

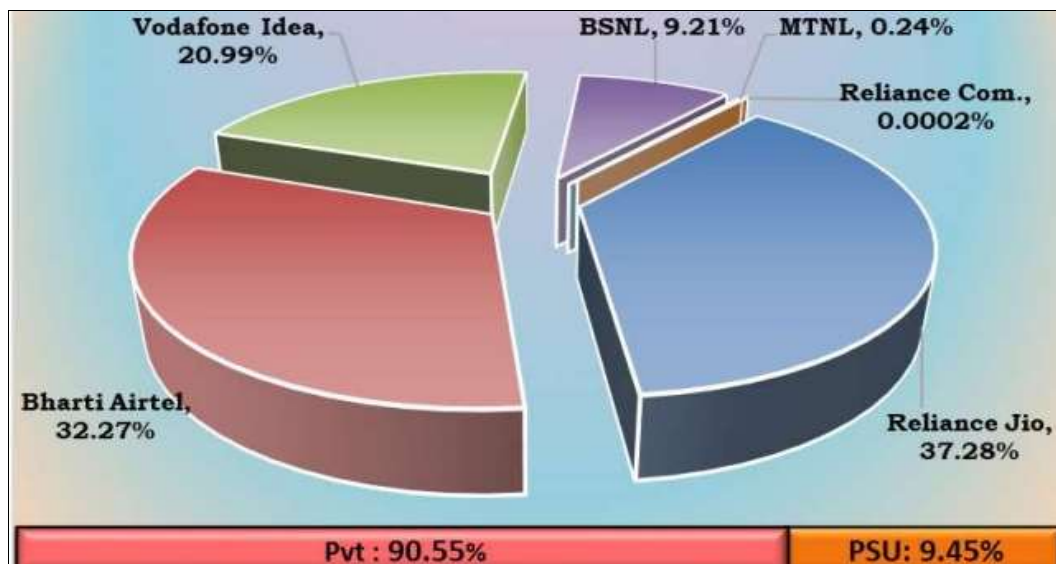


Fig 2: Access service provider-wise market shares in term of wireless subscribers as on 31st January 2023

In terms of market share, Jio was at the top position with a 37.28% share in the wireless subscriber market. Airtel's market share stood at 32.27%, while Vi was in the third position with a 20.99% share. BSNL claimed a 9.21% share, while MTNL and Reliance Communications held 0.24% and 0.0002% share.

(Million)

Year	2021	2022	2023
Total Revenue	44, 646.30	38, 849.10	42, 489.00
EBITDA	-2, 616.70	16, 331.50	17, 106.40
PBIT	-26, 255.20	-7, 252.80	-5, 943.30
PBT	-44, 253.40	-28, 234.10	-29, 297.60
Net Income	-44, 233.10	-28, 245.40	-29, 301.10
EPS	-15.39	-9.28	-8.43
DPS	0.00	0.00	0.00
Payout Ratio	0.00	0.00	0.00

(Source: Annual Reports of Vodafone -2021, 2022, 2023)

11. Analysis

- The company has been maintaining effective average operating margins of 28.55% in the last 5 years.
- The company has a high promoter holding of 50.36%.
- Voda-Idea’s Revenue has grown from 2, 87, 650 m in FY18 to 3, 86, 309 m in FY22.
- Over the past 5 years, the revenue of the company has grown at a CAGR of 7.7%
- Net profit has also grown at 58.4% in the last 5 years.
- Reported EBITDA margins were down 179 bps QoQ to 39.3%, below the expectation, with margins miss owing to lower-than-expected revenues (impacted by subscriber churn) and higher marketing costs.
- The reported loss this year was at 7,231 crore.
- VIL’s share price has declined by 63% over the past three and half years (Post-merger).
- The company has shown a poor profit growth of -

- 120.81% for the Past 3 years.
- The company has shown a poor revenue growth of 1.22% for the Past 3 years.
- Company has a poor ROE of -67.35% over the past 3 years.
- Company has a poor ROCE of -18.74% over the past 3 years

12. Limitation of the Study

The study is based purely on secondary data which was taken from financial statements and annual reports of the company's website. Hence, ambiguity of the data can't be declined.

13. Conclusion

VIL remains the weakest private Telco. The need for capitalization is urgent mainly due to its lagging spends on network and continued relative market share loss. So, the year 2023 looks more challenging for Vi unless the company brings some investment for real rather than the usual speculative kind of news. Vodafone Idea is not only reducing tariffs in the prepaid segment indirectly but also in the postpaid segment. But none of these lowered tariffs is helping the Telco fix the subscriber loss.

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