THE EFFECT OF MERGER AND ACQUISITION ON THE FINANCIAL PERFORMANCE OF ALIBABA IN CHINA

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Abstract

This paper seeks to evaluate the effect of mergers and acquisitions on company financial performance. In today's globalized economy, there is constant pressure on a company to expand into new markets. With this objective, more and more companies adopt mergers and acquisitions as the main mode of expansion. Alibaba is one of the biggest companies in the world and contributes to 80% of China's online shopping market and has used mergers and acquisitions for achieving rapid growth. This paper analyzed the Alibaba Company's financial performances over 10 years from 2007 to 2016 which includes a pre-merger period from 2007 to 2013 and a post-merger period from 2014 to 2016 to find out how the merger and acquisition affected the company's financial performance. Return on equity, return on assets and EBIDTA ratios increased after mergers with 2.93%, 4.12% and 28.2% respectively. However, the debt to equity ratio, gross profit ratio and assets turnover ratio have decreased after mergers, with 13.62%, 25.91%, and 2.04% respectively on the company's financial performances. The results of this study show that mergers and acquisitions had a marginal effect on Alibaba Company's financial performances from 2014 to 2016.

Keywords: mergers, acquisitions, Alibaba

Introduction

Mergers and acquisitions (M&A) activities provide companies with the quickest and most effective mode to expand market share, move into new geographical markets, achieve economies of scale, as well as a useful risk management strategy to diversify a company's portfolio (Kemal, 2011). While achieving the above objectives companies also need to improve financial performance. Financial performance is the main factor of any organization's success.

There are three largest e-commerce firms in china, which are Tecent, Youku, and Alibaba. Alibaba is the Chinese E-commerce giant, and is a leader in retail and wholesale trade of online and mobile marketplace Alibaba contributes to 80% of China's online shopping market (WSJ, 2015). Alibaba was established in 1999 by Ma Yun (Jack Ma),

launching an online consumer to consumer marketplace which is Tabao in 2003 and Tmall in 2008. The main focus of the company is to connect Chinese producers with domestic and international retailers.

To achieve rapid growth Alibaba entered into mergers and acquisitions to expand the business and improve shareholder's wealth. In 2010, Alibaba acquired U.S E-commerce software firm Vendio, and in the same year, Alibaba acquired Auctiva a company which develops eBay auction management software (China Internet Watch, 2014). Following the above Alibaba acquired a major stake in Suning an online shopping market in 2015, and Youku a video player website in 2016. Alibaba spent up to $38 billion on M & A during 2016 (Business Insider, 2016).

This research seeks to analyze the financial performance of Alibaba Company in China. The researchers will determine whether the mergers and acquisitions had any impact on the company's profitability, ability to meet its short-term debt capacity and its

Literature Review

Mergers and acquisitions are an important strategy to remain relevant in the business world. Various theories have sought to explain mergers and acquisitions and some empirical studies has tested these theories. Based on the previous research, researchers have studies the several economic impacts of merger and acquisition in different industries, and they had tested the changes in shareholders returns after mergers and acquisitions. However, mergers and acquisitions can also generate non-value-maximizing behavior for the parent firm. For example, Mitchell and Lehn (1990) found that managers who make poor deals leading to reduced profitability could become targets themselves. Tambi (2005) sought to determine whether M&A's contributed to synergy and economies of scale, and found that M&A's neither provided economies of scale nor synergy.

Yeh and Hoshino (2002) analysed 86 Japanese mergers between 1970 and 1997 to determine the impact of M&A's on the firms' operating performance. The performance of the companies was tested based on their effects on firms' efficiency, profitability and growth. The result showed that insignificant negative change in productivity and significant negativity in profitability, sales growth rate, and reduction in the workforce after mergers. In general, the results determined that mergers have a negative effect on firm's performance in Japan. The research done by Weston and Mansink (1971) found that M&As improved short term performance but had no significant effect on long term performance.

There are some discussions about whether the performance will be improved in long term. According to Andrade et al (2001) "mergers improve efficiency and the gains

to shareholders at merger announcement accurately reflect improved expectations of future cash flow performance" (p.117). The above findings are supported by Kruse et al (2007), which used 56 Japanese companies during the period of 1969 to 1197 as an example to evaluate the long term operating performance of manufacturing firms that adopt mergers activities, and found evidence of improvements in operating performance with highly correlated pre and post-merger performances.

Some of the more current evidence in this classification comes from studies comparing pre-merger and post-merger performance of firms in one industry at the same time. For example, some research observed that a decline in operating performance in term of profitability of the merged firms in different industries. Mantravadi & Reddy (2008b) found that the operating performance of non-financial institution, textile, pharmaceuticals and electrical industry gave negative impact on the overall operating performance of the mergers and even experiencing losses on the chemical and agriculture-products industries. The performance of the Chemicals and agriculture-product sectors after merger has declined in return on investment and profitability margins. Others like pharmaceuticals, textiles and electrical equipment sectors, the profitability decreased in performance and return on investment.

Research Method

This research adopts a qualitative research method. Following the above approach the paper uses descriptive analysis to analyze the data. 10 years financial data of Alibaba Company is used to analyze the impact of M&A on the company's financial performance. Besides, the data for 10 years it had to meet the following criteria: (i) the M&A activities must have been completed, (ii) the acquiring firms should not have multiple acquisitions during the relevant period to limit biasness, (iii) M&A activities with all sites of transaction value were considered, (v) it is acceptable if the acquired firm is small relative to the acquiring firm, (vi) all announcement and completion dates are to be available.

The purpose of this methodology is to use accounting data which measure actual performance and not the investor's expectation. This makes financial data more reliable. Besides, financial performance analysis over a sufficient period of 10 years should reveal whether or not merged companies lead to real financial gains. The financial information was collected from Alibaba annual report and Market Watch website. The Market Watch database provides company balance sheet, income statement, cash flow statement information, such as current assets, sales, expenses, total liabilities, and other company information like share price and some ratio analysis.

Profit is the ultimate goal of the organization. The goal of all strategies and activities designed to achieve this goal. However, this does not mean that company does not have other goals. The company may also have other goals such as economic and also social goals. In addition, the first objective of this study is to determine financial performance. To evaluate the profitability implication of merger and acquisition activities, this research uses the methodology from Healy et al (1992) and Cornett et al (2006) to analyze the performance of the firm. The financial data were collected for the year before and after the M&A activities from the firm annual report and made the comparison of the ratio before and after the activities which to determine whether have any changes in the financial performance of ongoing business of the company.

The following financial ratios were used:

$$\text{Return on assets} = \frac{Net\ income}{Total\ assets}$$

$$\text{Debt to equity} = \frac{Total\ Libilities}{Shareholder's\ euqity}$$

$$\text{Return on equity} = \frac{\mathbf{Net\ income}}{\mathbf{Shareholders'\ equity}}$$

$$\text{EBITDA} = \frac{Earining\ before\ interest, tax,}{Total\ revenue}$$

$$\text{Gross profit} = \frac{Gross\ Profit}{Total\ Revenue}$$

$$\text{Assets turnover} = \frac{Revenues}{Total\ assets}$$

The research uses both Microsoft Excel and Statistical Package for the Social Science (SPSS) to present the descriptive analysis. SPSS was used to test the mean, and Wilcoxon test to test the total mean of pre-mergers and post-mergers ratio. And Microsoft Excel was used to develop graph and tabulates research outputs.

Results and Analysis

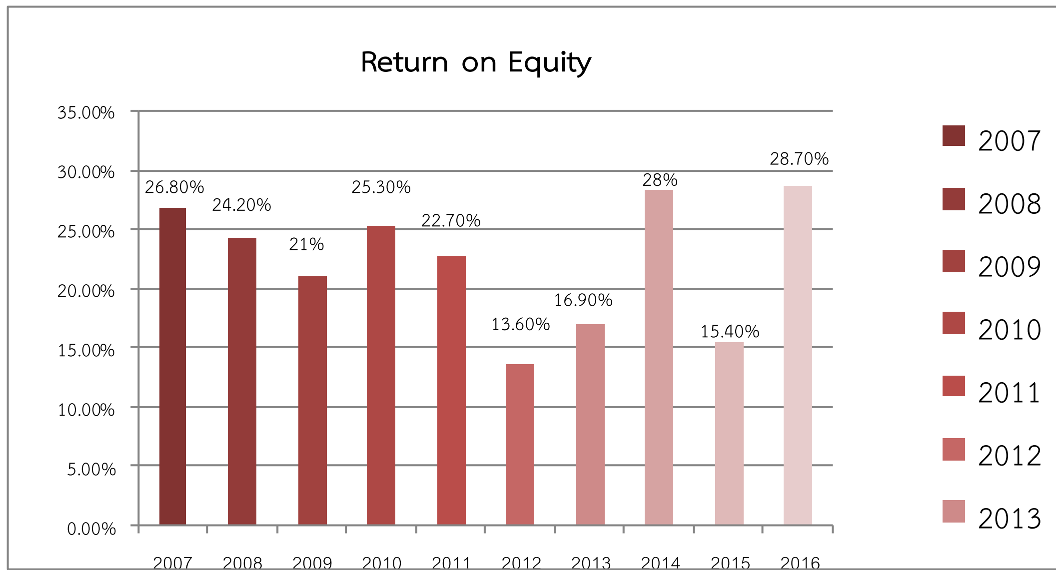
Table 1 presents the pre-merger ratios from 2007 to 2013 and post-merger ratios from the year 2014 to 2016.

Table 1 Pre-merger and Post-merger ratios

	Pre-merger							Post-merger		
	2007 (%)	2008 (%)	2009 (%)	2010 (%)	2011 (%)	2012 (%)	2013 (%)	2014 (%)	2015 (%)	2016 (%)
Return on equity	26.8	24.2	21	25.3	22.7	13.6	16.9	28.4	15.4	28.7
Return on Assets	16	15.3	10.7	11.6	11.2	9.9	13.6	21	9.5	19.7
EBITDA	44.75	47.16	30.4	30.7	16.3	28.0	33.8	55.2	46.0	82.5
Debt to Equity	0.67	0.59	0.9	1.2	1.0	0.37	102.8	2.3	0.62	2.3
Gross profit	87.04	86.7	86.2	83.2	70.6	67.3	71.8	74.5	68.7	66
Asset turnover	35.7	38.02	40.97	43.74	31.46	42.42	54.11	47.07	29.83	27.75

Sources: Alibaba Annual Report during period 2007 to 2013.

As mentioned earlier, the return on equity ratio is to measure how the company can use the shareholders equity to generate the company profit. Figure 1 provides a review of the return on equity ratio of Alibaba Company from year 2007 to 2016. Figure 1 highlights that the return on equity ratio is not really stable, especially in year 2012 and year 2015. Based on the Alibaba annual report, the net income of the first quarter of year 2015 was RMB 2,869 million, and compared to RMB 5,561 million of same quarter of 2014, it decreased by 49 %. Overall, compared to the pre-merger period from 2007 to 2013, the post-merger period from 2014 to 2016, shows a better performance, implying that the merger and acquisition activity has impacted on company performances.



Return on assets ratio shows how the company could use assets to generate profits. Figure 2 indicates that Alibaba Company was able to use its assets to generate profits, but shows a similar pattern to return on equity. The pre-merger return on assets compared to the post merger return on assets shows a similar pattern to return on equity.

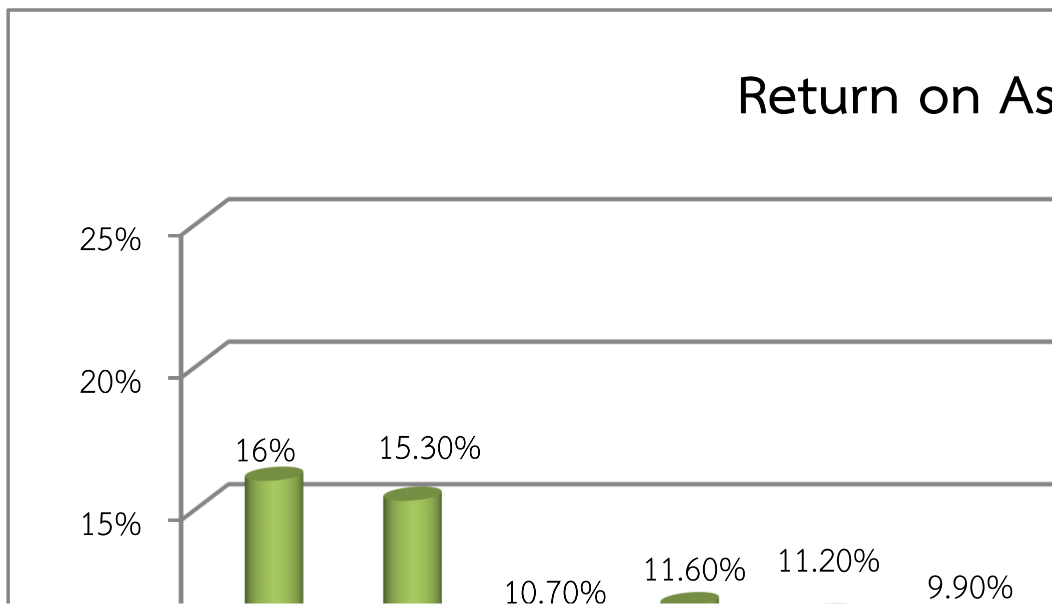


Figure 2 Return on Assets

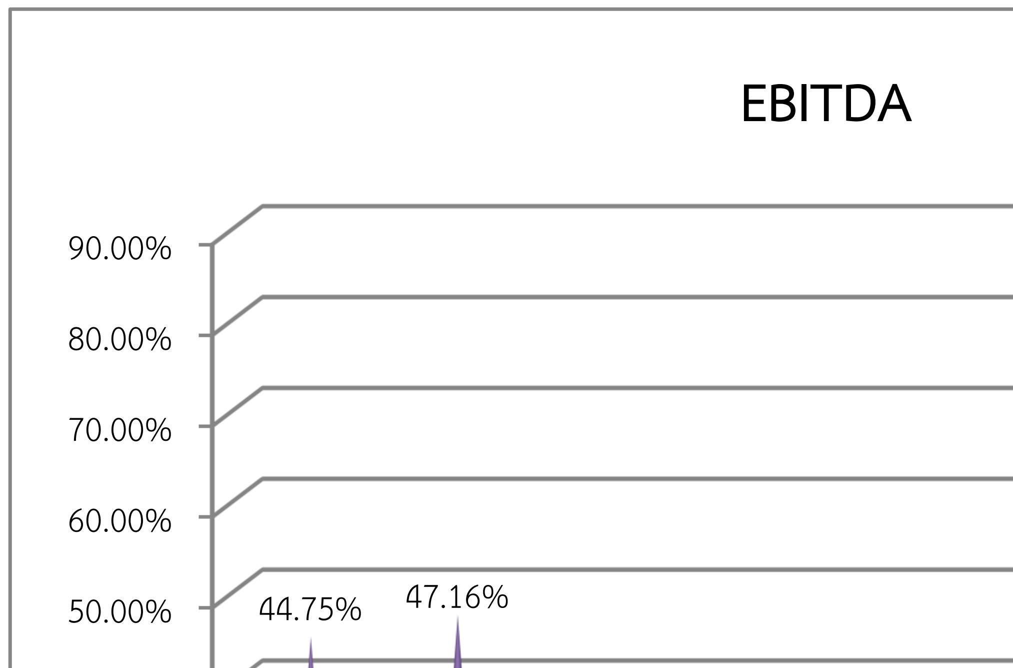


Figure 3 EBITA

Earnings before interest, tax, depreciation and amortization (EBITDA) ratio are another measure of the company's operating probability (Figure 3). In comparing the pre-merger ratio to the post-merger ratio, the EBITDA ratio increased in the year 2014 and 2016 respectively, which means merger and acquisition activities had positive effect on the company's performance.

Debt to Equity ratio is used to indicate how much debt a company is using to finance its assets relative to the amount of value represented in shareholder's equity (Figure 4). During the whole period the debt to equity ratio remained relatively stable except for 2013. This was mainly due to Alibaba's repurchase of the yahoo ordinary shares in year 2012.

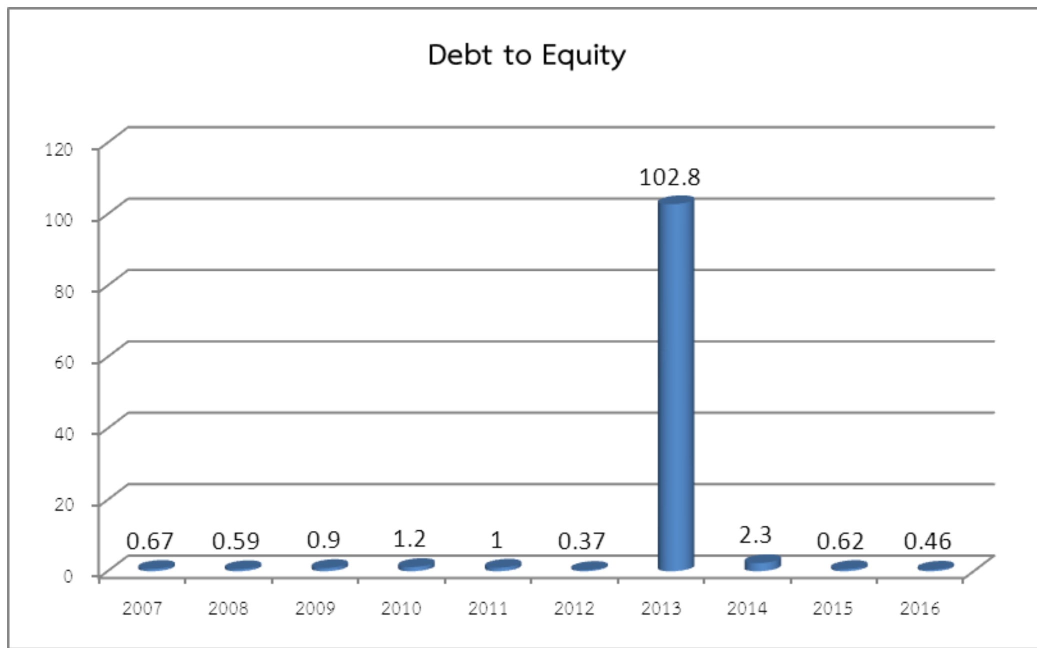


Figure 4 Debt to Equity

The gross profit ratio is measure of the company's margin on sales (Figure 5). Alibaba's gross profit ratio has shown a steady decline over the period from 87% in 2007 to 66% in 2016. This could probably be attributed to increased completion or the acquired businesses had a lower margin.

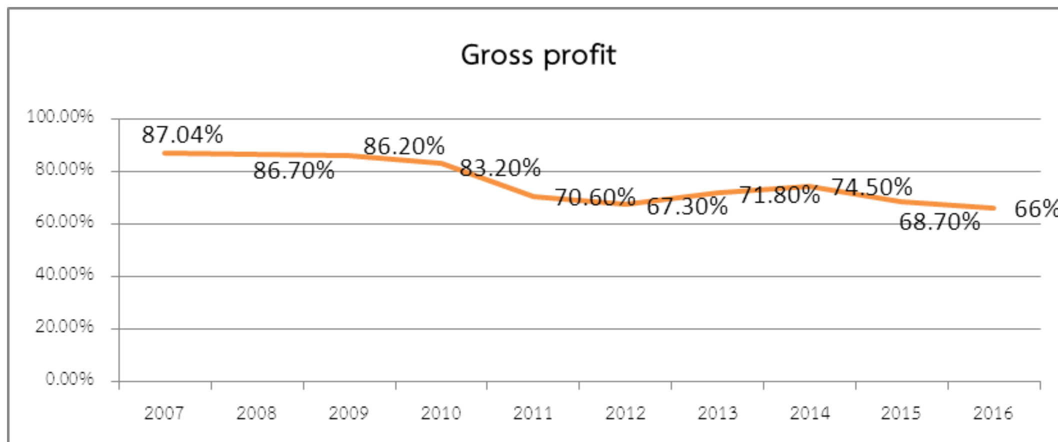


Figure 5 Gross profit

The assets turnover ratio highlights how efficiently the company is using its assets (Figure 6). The company shows a steady increase in the asset turnover ratio from 2007 to 2013 with the exception of 2011 but after that there has been a steady decline to 2016 highlighting inefficient use of assets in the post-merger period.

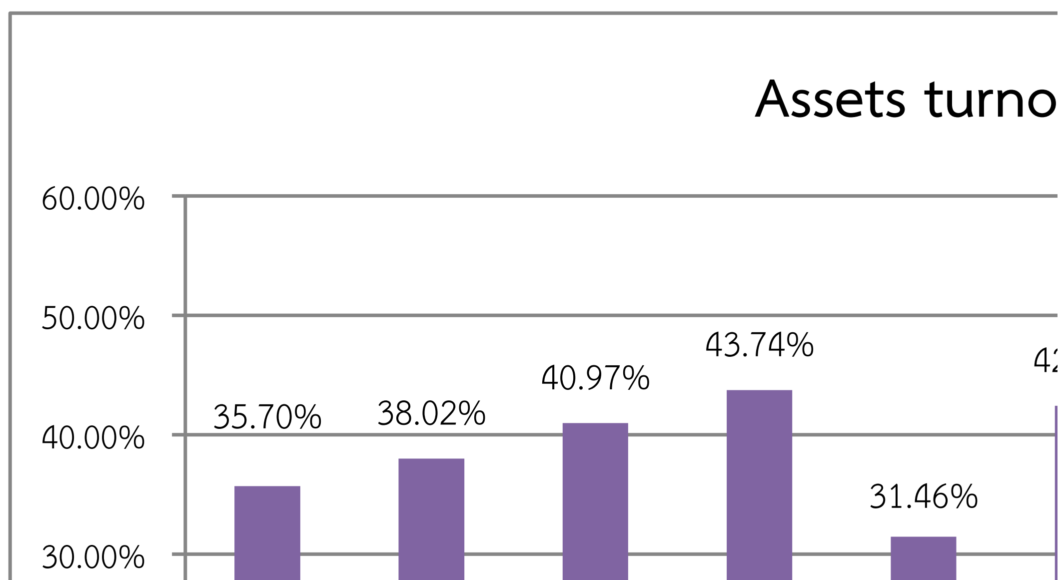


Figure 6 Assets turnover

Table 2 Means of pre-merger and post merger ratios

Financial ratio	ALIBABA		
	Pre-merger $\bar{x}$ (%)	Post-merger $\bar{x}$ (%)	(%) changes
ROE	21.50	24.12	+2.62
ROA	12.60	16.73	+4.13
EBITDA	33.00	61.23	+28.23
Debt to Equity ratio	15.36	1.26	-14.1
Gross profit margin	78.98	69.73	-9.25
Asset Turnover ratio	40.92	34.89	-6.03

Table 2 provides a summary of the pre and post-merger means. Most of the ratios improved after the mergers and acquisitions and are statistically significant. This indicates that mergers and acquisitions could improve companies' performances. For example, the mean of ROE, ROA and EBITDA ratio has increased after merger activities, with 2.62%, 4.13%, and 28.23% respectively, and it means these ratios has positive effect on the Alibaba's financial performance. However, the mean of gross profit and debt to equity ratio all decreased.

The financial ratio indicators reveal that mergers and acquisition at Alibaba led improved financial performance, and supports theories that synergies can be achieved As discussed earlier, agency theory is one of the major reasons why M&As often do not succeed. According to Ang et al (2000), agency costs can be measured by looking at assets turnover ratios. By using this thought, the small positive change in post-M&A assets turnover ratios showed in the table suggest a higher agency cost result from conflicts between managers and shareholders, as Humphery-Jenner & Powell (2011) suggested, it could lead to a lower acquirer return.

Conclusion

The literature highlights mixed evidence on the impact of M&As on company performance. Alibaba is a widely admired company globally and this study seeks to evaluate its performance before and after its M&A activities. In order to expand its market share rapidly, Alibaba has choose merger and acquisition activities as a core strategy. Whilst the return on equity ratio over the 10 years has fluctuated considerably there is a significant increase in the post-merger return on equity compared to pre-merger return on equity. The return on asset ratio shows a similar trend to return on equity. However, debt to equity ratio and gross profit has shown negative trends.

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