IMPACT OF STRATEGIC BUSINESS DECISIONS ON CASH FLOW STATEMENTS – A LENDER'S PERSPECTIVE

Dr. Abhinav D. Jog, Professor, Indira School of Business Studies, Pune

Abstract

Indian Companies have been generating steady profits since the liberalisation of the Indian economy in the early 90s. Since the beginning of this century, many of them have been deploying their profits into making overseas acquisitions. Consequently, many companies have transformed into Indian TNCs (Transnational Companies). On the other hand, companies which could not find good opportunities for acquisitions have opted to utilise the surplus cash generated to buy back shares and enhance shareholders' wealth. The effect of these strategic business decisions have been observed on the Cash Flow Statements (CFS) of TNCs over a number of years.

This paper examines the impact of strategic business decisions taken by two major companies belonging to Tata Group, namely, Tata Steel and TCS on their CFS.

Key Words*: Strategic business decisions, Cash Flow Statements, Indian Transnational Companies, Overseas acquisitions.*

Introduction

The first decade of this century marked the beginning of the era of acquisitions by Indian companies. In 2000, Tata Tea took over a global company twice its size, Tetley Tea, the second biggest tea company in the world. Another Tata Group Company, Tata Steel, acquired a company much larger than itself. At the time of Tata Steel's acquisition of Corus (2006-07), Corus was four times the size of Tata Steel in terms of revenues (US$4.6 billion for Tata as of March 2006, versus US$19 billion for Corus as of December 2006) and 3.5 times its size in terms of assets, according to data from S&P Capital IQ.

Between 2001 and 2012, Indian companies executed more than 1,100 cross-border merger and acquisitions (M&A) transactions according to Zephyr, Bureau Van Dijk's M&A database. These acquisitions were spread across multiple industries, with software and business services and pharmaceutical acquisitions being among the biggest industry groups. There are many factors driving this trend. Indian companies have realized that adopting a long-term competencies-building strategy with large investment in R&D, advertising, etc is relatively more risky and costly than pursuing the route of overseas acquisitions**. (**Jaya Prakash Pradhan, 2007).

The general literature on M&As, heavily influenced by industrial organization theory, has tended to focus M&As as caused by a set of motivations of the firms ranging from consolidating market position and accessing intangible assets of acquiring firm and achieving operating synergies in that process to survive in the competitive environment and even to overcome market limitation through cross-border expansion. (Pradhan, Jaya Prakash and Abraham, Vinoj, 2004).

The ISB-FDC Transnational Survey conducted in 2012-13 found that the motivation for acquisition by Companies is primarily to seek new markets to expand their outreach.

Figure 3: Acquisition motivations

Note: *The figure shows responses to the question: For the following completed acquisition, please indicate your company's motivation for undertaking the named acquisition: 1= not a motivation at all, 5= primary motivation.*

Source: ISB-FDC Transnational Companies Survey, 2012-13.

Data Collection & Analysis

The study pertains to two Tata Group companies, namely, Tata Steel and TCS and is based on secondary data collected from Audited Financial Statements of the two companies. The primary focus of this study is on the Cash Flow Statements (CFS) for 10 years from 2007 to 2016 for Tata Steel. CFS of TCS, on the other hand, have been analysed for a period of five years from 2012 to 2016.

 ISSN No : 1006-7930

Analysis of CFS of Tata Steel

Tata Steel

Cash Flow	------------------- in Rs. Cr. -------------------				
	Mar 11	**Mar 10**	**Mar 09**	**Mar 08**	**Mar 07**
	12 mths	12 mths	12 mths	12 mths	12 mths
Net Profit/Loss Before Extraordinary Items And Tax	**9,776.85**	**7,214.30**	**7,315.61**	**7,066.36**	**6,261.65**
Net Cash Flow From Operating Activities	8,339.00	8,369.22	7,397.22	6,254.20	5,118.10
Net Cash Used In Investing Activities	-13,084.86	-5,254.84	-9,428.08	-29,318.58	-5,427.60
Net Cash Used From Financing Activities	5,650.99	-1,473.13	3,156.42	15,848.07	7,702.46
Net Inc/Dec In Cash And Cash Equivalents	**905.13**	**1,641.25**	**1,125.56**	**-7,216.31**	**7,392.96**
Cash And Cash Equivalents Begin of Year	3,191.29	1,592.89	465.04	7,681.35	288.39
Cash And Cash Equivalents End Of Year	4,096.42	3,234.14	1,590.60	465.04	7,681.35

Source : Dion Global Solutions Limited

Tata Steel

Cash Flow	------------------- in Rs. Cr. -------------------				
	Mar 16	**Mar 15**	**Mar 14**	**Mar 13**	**Mar 12**
	12 mths	12 mths	12 mths	12 mths	12 mths
Net Profit/Loss Before Extraordinary Items And Tax	**6,126.52**	**8,508.89**	**9,713.50**	**7,836.60**	**9,857.35**
Net Cash Flow From Operating Activities	7,567.68	4,851.89	12,432.80	11,068.67	10,256.47
Net Cash Used In Investing Activities	-5,405.22	-2,382.10	-9,837.42	-8,522.40	-2,859.11
Net Cash Used From Financing Activities	-1,631.04	-2,957.21	-3,825.98	-4,281.59	-7,599.35
Foreign Exchange Gains / Losses	-0.12	0.02	0.00	0.00	0.00
Net Inc/Dec In Cash And Cash Equivalents	**531.30**	**-487.40**	**-1,230.60**	**-1,735.32**	**-201.99**
Cash And Cash Equivalents Begin of Year	421.93	909.33	2,139.93	3,900.53	4,102.52
Cash And Cash Equivalents End Of Year	953.23	421.93	909.33	2,165.21	3,900.53

Source : Dion Global Solutions Limited

Observations

In 2007, Tata Steel acquired Corus Group, Europe's second largest steel producer. This decision helped Tata Steel to augment its capacity by three times, put the company on the global map and spread the risks of the business of making steel.

This strategic deal impacted all the components of the Company's CFS. There was a steady cash outflow on account of investing activities as it acquired assets of Corus. The financing activities initially showed cash inflows as the Company raised funds for the acquisition. Subsequently, there were financial outflows as the Company repaid the debt.

The success of the deal can be assessed by verifying the increase in cash from operating activities post acquisition. In the case of Tata Steel, the objective of acquisition was to ramp up production capacity and reap the benefits of economies of scale. However, the Net Cash Flow from Operating Activities has gone up from Rs.5,118.10 crores in 2007 (around the time of the acquisition) to only Rs.7,567.68 crores ten years later. The major reason for this was the impact of the Financial Crisis of 2008 which caused a slump in the European market from which it is still recovering.

Key Learning

While financing a project, the lender should assess the sources and cost of borrowings of the Company and assess its ability to service its future repayment obligations out of projected cash from operating activities**.**

A case in point is that of King Fisher Airlines, which piled up debt to fund the acquisition of Air Deccan in 2007. A key financial indicator which was overlooked by lenders was that the Company had negative cash flow from operating activities. The Company's financial woes were compounded by the fact that the revenue generation, post the deal, was far below expectations and from 2010 onwards, its interest burden exceeded its operating profits. This ultimately lead to closure of its business operations and the lenders still have thousands of crores of public money stuck in the now defunct company.

Analysis of CFS of TCS

Tata Consultancy Services

Cash Flow	**------------------- in Rs. Cr. -------------------**				
	Mar 16	**Mar 15**	**Mar 14**	**Mar 13**	**Mar 12**
	12 mths	12 mths	12 mths	12 mths	12 mths
Net Profit/Loss Before Extraordinary Items And Tax	**29,116.64**	**24,549.97**	**23,544.47**	**15,703.18**	**13,366.33**
Net Cash Flow From Operating Activities	17,996.31	16,319.89	12,941.93	9,156.95	3,174.63
Net Cash Used In Investing Activities	-4,549.32	611.01	-7,189.32	-3,482.98	433.36
Net Cash Used From Financing Activities	-9,565.03	-16,914.20	-5,684.32	-5,655.80	-3,897.22
Foreign Exchange Gains / Losses	40.12	-27.26	43.66	-16.68	31.02
Adjustments on Amalgamation / Merger / Demerger / Others	31.61	1.97	2.57	3.39	0.00
Net Inc/Dec In Cash And Cash Equivalents	**3,953.69**	**-8.59**	**114.52**	**4.88**	**-258.21**
Cash And Cash Equivalents Begin of Year	429.78	438.37	323.85	318.97	577.18
Cash And Cash Equivalents End Of Year	4,383.47	429.78	438.37	323.85	318.97

Observations

The cash from operating activities has shown a nearly three-fold increase during the period under review. A part of the surplus cash has been used for repayment of debt as evidenced by heavy cash outgo in financing activities on a year-on-year basis.

Another portion of cash was used by TCS to make investments in mutual funds and government securities as indicated by outgo in investing activities. This investment yielded only modest returns. It could not find any attractive investment avenue to deploy the cash. This was partly because of the protectionist policies of the Trump administration in US- a major market for TCS. Given the headwinds in the business environment, the Company opted to buy back shares in 2017- and again in 2018. The main advantage of a buyback is that it reduces the number of outstanding shares of the company, boosting its earnings per share (EPS), and the return on equity (RoE) and increases shareholder value in the long term.

Key Learning

One effect of buy back of shares is that it causes a dilution of owner's stake. Since TCS is virtually a debt-free Company, this decision will not impinge upon the interest of lenders. However, if a Company is still servicing a loan and it meantime proposes to make an offer for buy back of shares, then the lender should ascertain its impact on the Debt-Equity Ratio. Further, a listed company is also required to take permission from Securities and Exchange Board of India (SEBI) for its proposed buy back of shares. SEBI grants approval after being satisfied that the Debt-Equity Ratio post buy back will remain within the levels prescribed under Indian Companies Act, 2013 and SEBI rules.

In 2019, the capital market regulator had rejected L& T's Rs 9,000 crore share buyback proposal on the grounds that the group's consolidated debt to equity ratio would cross two times the paid-up capital and reserves after the completion of the share buyback programme.

Conclusion

Cash Flow Statements should be scrutinised carefully by lenders and critically examined to assess the Company's ability to service its debt obligations from future cash generated from operating activities.

Biographical References

Annual Reports

Tata Steel Ltd.

TCS Ltd

Journal Papers

[1] Ghosh, A, Does operating performance really improve following corporate acquisitions? Journal of Corporate Finance, 7(2), June2001, 151-178

[2] Acharya,Ram,C, the impacts of merger and acquisition on firms profitability, a case study of Canadian firms. Journal of Finance, volume 4, 2000, 1605-1621

[3] Harbir.S and Montgomery.C, corporate acquisition strategies and economic performance, Strategic Management Journal,8(4),1987,377-386 .

Books

[4] Ross, Westerfield and Jaffee, Corporate finance (6th edition, Boston: Mcgraw-Hill/Ervin, 2002).

[5] Harward Business Reviews , mergers and acquisitions(Boston, HB SchoolPress,MA02163)